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BUSINESS EVALUATION **JUNE 2017**

Assessing an investment in any business means looking at supply and demand – who wants to buy the product or service, now and in the future, and who is playing in that market as suppliers of that product or service, today as well as tomorrow.

Current demand and supply is a matter of market research, desk-based and old-fashioned foot slogging it around the place. Future demand is more complicated, but historic trends and current metrics help project the demand, and there are plenty of pundits out there who write about the future, with varying degrees of accuracy. In this digital age, algorithms and artificial intelligence (AI) are being used to predict the buying behaviour of on-line retail consumers, cutting down on inventories and delivery times, as well as transport costs as multiple orders can be joined together into one delivery (as an aside, the hotel industry prides itself in predicting its guests needs and desires, and has never called it AI – it uses the term “service”!).

Future supply is more difficult, with information not always readily available about what your present and potential competitors are planning to do in the same space. In the hotel industry, however, future supply is, in the main, largely identifiable - and therefore predictable? You can see when a hotel is being built, and it normally takes a standard time to complete and open. Further, there is a great deal of information available, from the authorities who issue construction permits as well as data analysts such as STR, who specialise in the hotel industry. And developers and hotel chains are normally quite eager to announce their new projects, to demonstrate to their customers and shareholders that they are growing.

Because a new hotel’s rooms normally open all at once, instead of being trickled into the market to match demand growth (I think of it as the “pig in the python” impact!), it is really important for investors in both new and existing hotel operations to understand the scale and nature of future supply entering the market. It should be predictable – but in reality, at least in African markets, it absolutely is not.

Two markets that I am closely involved in, Lagos and Luanda, are classic case studies.

Ever since I moved to West Africa in 2003, I have been told that there are too many hotels being built in Lagos, that the market will be over supplied, it is not a market for consideration for new investment. At the latest count, there were 23 hotels, with almost 4,000 rooms, in the international and regional chains’ development pipelines, deals signed between the hotel groups and investors for new hotels. I reckon there are at least another 1,000 rooms in other, non-branded hotels, either under construction or planned in Lagos.

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The total of 5,000 rooms, with opening dates estimated between 2017 and 2024, would more than double the existing supply of mainstream hotel rooms. That would be unsustainable if it were all to happen, even if demand growth were to return to pre-recession levels.

It's not going to happen. Having looked at each deal in detail, I reckon that only 14% of the rooms in the pipeline can be classified as "definite", with the remaining 86% either "unlikely" to open, or merely "possible". And what does "definite" mean? Well, it means that work on site is currently progressing, albeit in some cases only very slowly, and that the hotel should open, some time. Hardly definite, in the context of the history of hotel development in Lagos – in 6 hotels with 28% of the total pipeline rooms between them, there has in the past been construction undertaken on site, but work has now stopped (in one case over 6 years ago), with no confirmed restart date. Those hotels were at one time classified in the analysis as "definite", but are now either "possible" or "unlikely".

By my estimation, there are fewer than 800 rooms in hotels that are actually, continuously under construction in Lagos; of these the 250-rooms in the Marriott Ikeja are the only ones in a branded hotel with more than 100 rooms.

I was in Luanda recently, after a two-year absence. I had looked forward to seeing a multitude of new hotels, confirmed by me in 2015 as being actually under construction; I had been to see the project sites. At that time I metaphorically "kicked the tyres" of no fewer than 9 hotels, with 2,400 rooms between them, all slated to open between 2015 and 2019. As of March 2017, only one of these hotels, the 120-room Ibis Styles in Talatona, had opened. There was the 389-room Intercontinental Hotel & Casino, two years ago seemingly ready to open any day, with the furniture in place, still not open.

The 361-room Sofitel has been topped out, but the site is closed, devoid of activity. The same with the 370-room VIP Grande, the 461-room (yup, they make 'em big in Luanda!) Hotel Baia de Luanda (not to be confused with the existing Hotel Baia) and the 200-room Chik Chik Hotel at the airport. Work on the Continental Horizonte and the Bikuku Alvalade was progressing at snail's pace, and possibly not at all at the latter, sometimes it is hard to tell!

How can you plan in conditions such as this? Of course, one can take the view that the absence of new supply entering a market is a good thing, increasing the occupancy in existing hotels, and driving up room rates and therefore profits. That's true, but only up to a point.

Take the Intercontinental Hotel in Luanda. Will it open? Won't it open? There is no public knowledge regarding its future, and of course rumours abound. Why didn't it open two years ago? No one is saying. Will it be an InterContinental-branded hotel (note the capital C)? Will it have a major impact on the market? You bet! There are no hotels in central Luanda with a global brand (the Ibis Styles is in Luanda Sul, a new city some 13 kilometres south of the CBD).

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Should the Intercontinental Hotel open with an international brand, it will have the global distribution systems and reach that the existing hotels lack, and will be the main competitor for the upcoming Sofitel. So should the investors in the Sofitel, or any other planned hotel of that calibre, plan for the opening of the Intercontinental or not? Two years ago the answer was a resounding “yes” – it was ready to open, wasn’t it? Yeah, but, it didn’t! Will it open?! Won’t it open?!

A quandary indeed, when it should be relatively clear cut regarding the scale and timing of new supply, given the lead times involved. I tell my clients, who are potential investors in new projects, that, given the history of hotel development in many cities in Africa, not just Lagos and Luanda, only they, the risk takers, can decide whether to assume that a new hotel will or will not open, and factor that into their decision making. Of course scenario analysis can model financial projections assuming different levels of future supply, and the investor can use that analysis as an important input. But if the experience of those two cities is anything to go by, the scenarios will all turn out to be wrong, with not even AI helping much!

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