

A blue banner featuring a suspension bridge on the left and a grid pattern on the right. Overlaid on the grid are city names and dates: PARIS 08 05, BUDAPEST 09 05 10, CHIOS 10 00 04, PARIS 10 10 04, and TUNIS 10 15 04. A yellow arc logo is positioned above the text.

BRIDGING THE GAP BETWEEN *PLAN AND PERFORMANCE*

# 2009 Trends in Travel Investment

Mike McCormick

Managing Partner, Hudson Crossing LLC

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## 2009 Trends in Travel Investment Summary

As we now know, courtesy of the National Bureau of Economic Research (NBER), the current US market recession began in December of 2007. Therefore, we are at least twelve months into a long and pronounced economic downturn. As in previous recessions, we fully expect that the current market will not support the breadth of travel firms that were created during the last expansion cycle. In summary, we expect 2009 will bring consolidation and restructuring for the travel industry in most every sector.

Some of the key drivers of this consolidation will be reduced enterprise valuations, limited access to capital, and lower expected future demand for the products and services being offered. Coupled with large amounts of debt repayment and other related costs on many balance sheets throughout the industry, a significant industry restructuring is both necessary and inevitable.

In light of these assumptions, we provide our seven major predictions for investment and economic activity in travel for FY 2009.

## **1. A major OTA brand will be sold.**

The space for Online Travel Agencies (OTAs) has become crowded and the current downturn in consumer spending on travel will force one major OTA into a change of ownership.

The challenges that face OTAs are numerous and multifaceted. From the competitive view, OTAs are experiencing sustained pressure from suppliers who are increasingly competing for direct bookings with travelers while simultaneously compressing OTA margins. Independent hotels have discovered the effectiveness of search engine optimization and pay per click advertising, which is allowing them to efficiently reach consumers without an intermediary. In addition, price parity now exists for much of the inventory found with OTAs. Firms like Kayak are creating additional disruption by continuing to aggregate consumer booking demand, further distancing OTAs from their end consumer.

One bright spot will be the opaque providers such as Priceline and Hotwire who will comparatively benefit from increased hotel inventory and lower net pricing along with an increase in price sensitive buyers.

## **2. Previously insulated from market forces, luxury travel will suffer a significant global downturn.**

Forget “staycations”. Once unassailable luxury brands will feel the chill of the economic downturn as more affluent consumers experience an accelerated erosion of their net worth and make downward adjustments to their willingness to spend on travel.

With the housing and stock markets are not predicted to return to pre-October 2008 levels anytime soon, even affluent consumers will trade-down to mid-scale properties or less expensive destinations. It’s often been stated that the perception of personal wealth is experienced in three categories; home equity, stock appreciation, or improved employment prospects. In the fourth quarter of 2008, all of these sources of capital suffered major setbacks, and as a net result, affluent consumers feel much less affluent.

As a result, premium travel brands will have a tough time selling high-priced inventory. We predict that luxury travel brands will experience a significant reduction in revenue and will counter by lowering rates and offering more specials to entice fence sitters to indulge themselves despite the economic conditions. We expect the luxury segment will not begin to recover until late 2010.

### **3. Corporations (instead of venture capital) will lead the investment activity.**

Most recessions create an environment where market consolidation is a natural effect of cheap assets with a marginal chance of independent survival seeking to exist. Darwin called it “Survival of the Fittest”. This recession will be no different and we predict that the consolidation will be led by corporate buyers as opposed to over-leveraged private equity or less-aggressive venture capital investors.

In the next twelve months, we expect significant acquisition activity on the part of corporate buyers who look to add to their product set or shore up market positions in new or emerging markets. In the short-term, valuations will be compressed to the point that potential acquisitions will either be inexpensive or immediately accretive.

As a byproduct of this acquisition activity, we expect failures of smaller firms in travel who are in the 3rd or 4th positions in their marketplace with less access to capital and fewer strategic alternatives.



#### **4. The US airline industry, due to reductions in capacity and (relatively) lower fuel prices, will ride out the current downturn with better than expected performance (and without government subsidy).**

For perhaps the first time in recent memory, the airline industry finds itself in the enviable position of having taken the tough medicine ahead of an economic downturn and is in a position of relative strength. Emphasis on relative.

Due largely to pre-emptive cuts in capacity forced by the summer's high oil prices, airlines have already positioned themselves for cuts in demand. Now, with falling oil prices, already reduced capacity and extensive ancillary fees in place, airlines are poised to weather the storm.

In the next twelve months, look for airlines to lock-in long-term oil contracts and slowly add capacity back to their networks. While 2009 will not be a banner year for the airline industry, it will also not be a year of extended gloom and doom as it might have been only one short year ago.

## **5. The global hotel industry will manage this downturn better than 2002-2003, but will feel the full brunt of the economy in late-2009.**

The hotel industry has been one of the primary benefactors of the recent boom years – historically high Average Daily Rates (ADR) and increasing valuations of real estate.

Welcome to 2009.

The housing bubble not only has de-valued the real estate holdings of major hotel chains, but also left them with too much inventory in markets where demand has dried up. Overdeveloped destinations such as Las Vegas will take years to return to their pre-crisis occupancy levels.

In the next 12 months, we expect that many hotel chains will be forced to make some of the same cuts that their airline counterparts have already made during much of 2008...namely cuts in services and amenities along with headcount reductions. Independent non-chain affiliated hotels will be particularly hard hit without the backing of strong, global brands, sales forces and loyalty programs. We expect ADRs to decline and begin to recover in late 2010.



## **6. Online advertising and media oriented businesses will be the sole bright spot in short-term travel investment performance.**

The current economic weakness has had no effect on online media properties which continue to see unabated growth in their online visitors. This bodes well for firms in online media in the travel sector where advertisers continue to shift more of their spending online and travelers use a greater variety of sites to plan and manage their travel activities.

While it remains true that advertisers have cut back on their overall marketing budget, the transparent nature of online marketing makes it easier to defend online budgets where a strong ROI is demanded by every CFO.

In a recent survey of investment bias amongst investors in travel, we found online media to be the one lone sector within travel where sentiment and investment remained bullish. We expect more deals to be conducted in online travel media in 2009 although at lower valuations.



## **7. Mobile will begin to emerge, converge and finally arrive in travel.**

The long expected rise of mobile computing in travel has been greatly over-hyped. What we believe is different in 2009 is that we expect the advent of two viable mobile computing platforms (the iPhone<sup>®</sup> and BlackBerry<sup>®</sup> Storm) to have a catalytic effect upon the use of mobile travel applications.

Current mobile travel applications run the gamut of mobile search and booking applications, to unique destination travel content, such as [Wheretraveler.com](http://Wheretraveler.com) (a Hudson Crossing client).

What many of these mobile applications have in common is that they take advantage of the convergence of mobile computing usability with easy to access information or travel content over a 3G network that will make the act of traveling itself easier and more enjoyable. Look for more applications to be developed and discussed in 2009, even while fewer people will travel and are willing to spend less to do so.

## Our Conclusions

While 2009 will be a year of change, it will not be a year of failure in travel. We expect strong companies to emerge even stronger as they head into 2010 with perhaps even more customers, better products, and fresh market strategies.

Weaker companies in their market will face fewer strategic alternatives. Several will restructure and a few will declare bankruptcy. The airline industry, usually the canary in the mine of economic change is in a relative position of strength. Their hotel and car rental counterparts, however, are not so lucky.

Online media and mobile apps will dominate the headlines in travel in 2009, and heading in 2010 will make big waves when demand returns to a period of normalcy.



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Mike McCormick  
Managing Partner, Hudson Crossing LLC  
+1.212.845.9893 x802  
[contactus@hudsoncrossing.com](mailto:contactus@hudsoncrossing.com)

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