

**HOSPITALITY INDUSTRY:
HOW DID THE SURVIVORS SURVIVE?**

Welcome and Introductory Remarks

Anne de Louvigny Stone – President, Essec USA Alumni

Tonight, we have brought together leaders in the hospitality industry to address, “The Hospitality Industry: How Did the Survivors Survive?” We’ll look at how the industry is reinventing itself after a worldwide recession that has posed special challenges to hotels, restaurants and travel operators worldwide.

It is my pleasure to introduce Michael Noden, the Visiting Senior Lecturer in Management, Marketing and Tourism at the School of Hotel Administration at Cornell University. He is an expert in the area of tourism policy, promotion and development, with many years experience as both an owner and manager of wholesale and retail travel agencies in the US. He also has management experience in such agencies as Thomas Cook and American Express and acts as a consultant to both the private and public sectors.

Malcolm Noden

Let me introduce the panel. Mark Abramson is the Senior Managing Director at Bear Stearns & Co. I’ve been asked to remind you that Bear Stearns has an investment banking relationship with FelCor Lodging Trust, Host Marriott Corporation, and Starwood Hotels and Resorts. Bear Stearns or one of its affiliates holds 1% or more of the common equity of Host Marriott Corporation.

Daniel Boulud is a well-known visitor to Cornell, where our faculty thinks of him as someone who descends from Olympus. He opened his first restaurant in 1993 and it has probably been New York’s best-awarded restaurant in many years. There are more Cafés Boulud and other operations coming. He is one of those rare people who combine an understanding of the culinary arts with the business in which he’s engaged.

We’re also privileged to have with us the Group Chief Financial Officer from Accor, Jacques Stern. I did some work for them some years ago and found them to be a fascinating case study from the standpoint of the peculiar and specific models they use for their hospitality brand.

Bjorn Hanson is the Global Hospitality Managing Partner at PricewaterhouseCoopers. He is widely quoted about hospitality industry issues. In addition to having been the International President of the Cornell Hotel Society and a Visiting Assistant Professor at Cornell, he has also been an adjunct faculty member for 16 years at NYU, where he got his PhD.

Panel Discussion

First, for Mark Abramson: from your experience, what general business conclusions might we draw from the separation in the hospitality industry between ownership of the asset and management?

Mark Abramson

The public equity markets value these business models differently because they have different return-on-capital profiles. The pure management businesses are valued more highly. What we've seen in the past year and expect moving forward is that the pure management model will be harder to come by. In management contracts for hotels, operators are increasingly asked to invest in some equity and that is blurring the line between the pure operator model and management model.

Malcolm Noden

Jacques, what about from the viewpoint of larger public companies?

Jacques Stern

In lodging, the mid-scale and economy segments differ from upscale. Management contracts used to be straightforward, but not today. Now the owner asks for more commitment from the manager, through either equity, rules, or minimum guarantees. The difference between the operator and management company will be harder to see in future. Accor is very different from most companies in the US, because we are more in the economy and mid-scale markets. We have expanded and done most of our business through the operational model. We are not only managers, but we operate most of the assets through owned or leased formulas. The future goes better for us in the sense of valuation. The market will recognize that the way we spend is the best way to capture the upside.



Mark Abramson
Bear Stearns
Senior Managing Director
Head of Global Hotels &
Gaming Research team

Malcolm Noden

Customer demographics and behavior are changing. I'd like to ask my restaurant business colleague to identify some new consumer trends.

Daniel Boulud

I am definitely more of a local artist than a global businessman. Having made my name in luxury product, I know I have to keep diversifying to keep satisfying my clientele. I'm benefiting from both the more downscale restaurant bringing [customers] upstream to the upscale, and the upscale [customers] going downstream.

Malcolm Noden

Are you seeing new behavior among customers?

Daniel Boulud

Even people who can afford to eat in an upscale restaurant don't want to every day. They want to be in jeans and eat with their fingers.

I'm not in a trendy business. I'm looking at establishing a long-term relationship with my customers, but at the same time, we want to know how to be on the edge of the trend without being dipped in it. Trendy customers' fidelity is short. My colleagues in trendy businesses are successful, but they are looking at what they are going to do next when this thing deflates.

It's different for me. As long as I create labels that represent me well, with the same principles for the upscale as the downscale, I think I will keep making the best product for my customers.

Malcolm Noden

Jacques, in your more global environment, are your customers becoming more diverse? What are the trends?

Jacques Stern

Our challenge is to bring the customer what he needs, but also to operate as efficiently as possible and bill the hotel at the lowest price and best return. We keep this worldwide view of products, but localize the products to fit with local demand. This is a day-to-day challenge, to adapt products to the customer. In China, when we bring Ibis, which is a two-star product, obviously the size of rooms and lobby are completely different from what's in Paris.

Malcolm Noden

Bjorn, are there factors happening in overall demand markets?

Bjorn Hanson

Demand segmentation has become a science. For 20 years now, we have been relying on baby-boomers (39-58 year-olds) to drive business in the future. The presumption was that as they got into their late 50's/early 60's, they would use their leisure time to travel. That is happening, not quite to the degree that was expected, but they're supporting the lodging industry globally.

A pleasant surprise is that the Generation Xers (24-38 year-olds) have started to appear as the dominant demand segment across Western Europe and North America. Although not in their higher earning years yet, Generation Xers are spending on a per capita basis 9.7% more (in 2003) on travel than baby boomers. By 2006 or 2007, it looks like in North America there will be more occupied room nights by Generation Xers than from baby boomers.

Mark Abramson

As demand patterns change, the best way companies can adapt is if they have control. Pure franchisers don't have as much control over the asset positioning of the brand.

Malcolm Noden

Daniel, can you give us your insight on the issue of brand extension?

Daniel Boulud

When we opened the Café Boulud in Palm Beach, there was an adjustment there, to reflect what the one in New York means, but also be a local product—feeling the locals there rather than trying to impose something on them.

I can diversify into other things (e.g. gourmet company, line of cookware product) if it's something I care about, is related to the kitchen, and presents that image. But the main thing for me is I'm an artist and I have to be careful while I'm expanding not to dilute what I do best. I therefore have a wonderful director of operations, who is a Cornell graduate.

It's different for a restaurateur than an hotelier, where there's more real estate involved. As long as I'm making a restaurant in this town, I'll finance it with my partners. But the problem of every chef is if he wants to expand without too much financial risk, he has to go out of town to Florida, Las Vegas, London, etc.

Bringing a superior product is important as well; we apply the same principal of "best restaurant" to all the things we do.



Daniel Boulud
Daniel
Chef-Owner

Malcolm Noden

Part of your brand extension is to move into other geographies?

Daniel Boulud

Very much.

Jacques Stern

The problems are the same whether you have two restaurants or a family of hotels: to keep the consistency of the brand and what you offer to customers. This leads, at the end of day, to the people running the hotel or restaurant. It's the only way to achieve consistency. Training and human resource policy is important. That's why we have an academy.

Malcolm Noden

Are you concerned about consumer behavior differences between the US and emerging markets?

Jacques Stern

It's like the Chinese example I gave before. You have to be able to adapt a worldwide product to a local market. For example, in France, we have a short breakfast. In Germany, you can't give this kind of breakfast. So, we act global but we need a local aspect to the product.

Malcolm Noden

In the hospitality industry, there is a whole array of new distribution models. How good are they?

Bjorn Hanson

Regarding the Internet as distribution channel for lodging, the timing of the launch of especially the merchant model (Priceline, Expedia, etc.) happened when the US lodging industry had its lowest occupancy in all but seven of the last 75 years. On top of that difficult business trough, over \$1 billion was spent by those companies to launch their new business model. They were able to concentrate their marketing dollars on the statement, "Hotel rooms for a lot less."

An analysis of what happened in 2003 revealed that there were about 26,000 extra occupied hotel rooms per night in the US attributable to the Internet pricing and distribution network. That generated about \$700 million in incremental revenue. The bad part of the story is that the increased transparency and comparison shopping led to price competition and a more informed buyer. It cost the industry about \$2 billion in rate, so the net is a negative \$1.3 billion. Lodging industry conferences do not have kind things to say about these models.

Keep in mind that the merchant model buys the rooms at a price and resells to consumers at a mark up of between 15–40%, most commonly 15–25%. That sounds egregious, but the hotel is not paying travel agent commissions, GDS fee, hotel brand reservation fees, and credit card commissions.

Will brands be able to retrieve control of some of their guests and start to use the merchant model and other outlets when occupancy is at 80%? We may not see an answer for a couple years. I'm optimistic that with better control of guest relations and better timing on when rooms are made available at discount rates, it could be a positive for the industry. This year will be a great year: 61.7% occupancy in North America, with almost 40% of rooms available on a typical night. A little distribution of lower rates could be very positive for the industry.

Jacques Stern

With something new like the Internet, you have to make your own experience. Because it was a bad time for the industry, they didn't look carefully at the impact on price. This is wider in the US, because in Europe, the Internet is less developed. Although there was a bad impact in the US in the past two years, this is a great chance for the industry. Eighty percent of our Internet bookings are done on our own website, plus our relationship with Expedia is on a commission basis. It's a win-win situation: we keep control of price and have all the media through which to sell.

Malcolm Noden

We tend to focus on transportation and accommodation, but distribution has begun to affect the food and beverage industry.

Daniel Boulud

We are not the same as the hoteliers. We don't bargain down the price because we're using the Internet as a platform for selling tables in the restaurant. We have a system called OpenTable and we put all our reservations into this system. You can put as many tables as you want into their Internet

service. In a restaurant where you book more tables in a week than a month, I don't mind giving them tables. At a restaurant like Daniel, I give them very few in the front and back and good luck to them.

Mark Abramson

Control and distribution are important in terms of valuation as well. It's not entirely inconsistent with what I said before about a manager not being able to control their brand. The fact that Four Seasons controls 100% of their distribution is the exception that proves the rule. They have control over the brand. It's probably more important at the luxury end.

Malcolm Noden

Does the market see that as a sustainable strategy?

Mark Abramson

Yes, the actual penetration of the Internet into the overall distribution pipeline is quite small. It gets a lot of press and discussion, and the absolute numbers are big, but the relative size of the overall market is small.

Jacques Stern

One trend apparent from the Internet is that it is more difficult to run the business if you have a franchisee. You are less able to control how they act through distribution. One reason why the Internet has had such impact in the US is that half of the rooms are through the franchise system. Individuals want money at the end of the month. They don't care about three months or a year later. If the brand is not producing, they change the brand. This probably leads to a change in the way that bigger operators are handling the business.

Malcolm Noden

How do you optimize return on marketing investments when you're dealing with a multi-brand operation?

Jacques Stern

Seven years ago, we asked ourselves the same question. Accor had eight or nine brands in each country and had to run the marketing on the sales side for each brand. As the distribution channels were changing, we asked how we handle that and be more efficient globally. Our answer was to present Accor as an umbrella over the brands. We wanted to give a sense of what Accor is: value for money (mid-scale and economy products) and certainty for our clients' expectations of services. Also, with Internet distribution, we can sell by location and price and then provide a choice of our hotels.

Daniel Boulud

And that represented what percent?

Jacques Stern

I would say between 2–3%, but also with the billboards, which, probably with the sign on the roof, is how we can express our products.

Malcolm Noden

Mark, can you comment on the construct of marketing investment?

Mark Abramson

The integration of marketing efforts—aligning them properly as part of the growing rationalization and consolidation of back offices—has happened for a lot large companies as there has been a lot of consolidation across the industry over the past decade. There’s probably going to be more consolidation and more opportunities to rationalize marketing.

Malcolm Noden

What capital sources are there in the international markets?

Mark Abramson

Types of capital are different around the world, and different based on the size of the business. In Asia, capital sources view hotels as a form of real estate, and real estate returns in Asia tend to be low. In the US, the investment community views hotels in terms of cash flow—current yield rather than their capital appreciation.



Bjorn Hanson
PricewaterhouseCoopers
Global Hospitality Industry
Managing Partner,
Hospitality & Leisure Practice

In the US, you have real estate cap rates in the 9–10% range, while in Europe they’re 6–7% for the same hotel asset. Yet in the US, hotel multiples are higher than in Europe. Part of this is due to the existence in the US of real estate investment trusts, which have an immediate tax advantage in the valuation of the business, whereas in Europe, tax leakage affects the value of the business. Looking ahead, the introduction of unique structures in France years ago that may become more common, and potentially the introduction of new laws in the UK might eliminate this tax advantage.

Malcolm Noden

The metrics are viewed differently because of the different basic views of the nature of the investment itself?

Mark Abramson

Yes.

Jacques Stern

This is one of the biggest challenges we have. Finding a good location is only half of the job. The second part of the job is to find a good formula for financing, which must be adapted to the profile of risk. In Brazil, the economy is very unpredictable. To have long-term fixed financing there is crazy. We need variable financing linked to EBITDA, so the financing doesn't purge the P&L if the economy goes bad. Nobody except Brazilian firms will reinsure in Brazil. If you don't find this financing, you can't go to Brazil, but if you find it, then you have a way to expand without taking too much risk.

In the US or Europe, the formula is to have costs fixed as much as possible in order to capture all the upside. There is a lot of funding available there. The issue is how it's seen by the ratings agencies. We need to find funds and adapt the formula for each country.

Bjorn Hanson

The private equity markets related to lodging can be a mismatch. Private equity funds usually accept more risk for a higher rate of return. They usually have two criteria: cash flow fairly soon (so that is not good for construction or a new concept), and an exit strategy typically within three to five years. The uncertainty of the public markets and the uncertainty of the success of a new venture make a mismatch for many of the equity funds. We now have 240 equity funds that say that hotels are part of their strategy, but I would say the number that have found investments is a third or less.

The cost of capital is also a barrier for private equity funds. They're dealing with risk and therefore looking for higher rates of return. Some deals that look feasible with a public execution don't look so good when they have to pay a 20% rate of return.

Participant

Can you share your thoughts on where the professional ownership model is going and its longevity versus timeshare?

Mark Abramson

The increasing popularity of timeshare, particularly at the luxury end, is partly a phenomenon of a larger underlying trend over the last 10 years, which is a shift in ownership from private hands to institutional investors, who are more interested in cash flow in the near-term than long-term appreciation or prestige value. The best way to monetize a high-end hotel is to sell timeshares. I'm not sure it's the most long-term value maximizing approach, but for publicly traded companies, it looks good in the short term.

Bjorn Hanson

Consumer research reveals that 15-20% of households indicated interest in owning some type of vacation ownership interest. The current ownership level is less than 5%. Research also reveals that consumers are concerned about credibility and trustworthiness. Now major brands like Starwood, Marriott, and Disney are lending credibility. The second criteria is flexibility; exchange programs now make the flexibility that much greater. These factors make it a growing market. Last year, timeshare sales grew about 7% over prior year. We expect that to accelerate over the next few years.

Participant

How did bank and financial institutions help the industry to overcome the crisis?

Daniel Boulud

I'm sure on a big scale, it's the same, but on a very small scale, if you wish to get money from the bank, you need as much money yourself, otherwise they don't give it to you. Even if you have equity in real estate, you can barely get it.

What I did when the market was slumping was to keep doing what we do best. Our difference is our people working in the business, so we have to protect them and make them feel proud and motivated for what they do.

My role is to diversify my marketing, such as creating cookbooks about what I do. The bottom line is how much people trust the kind of experience they're going to have coming to me. That's the same for every business.

In Europe, they're a little easier about giving you a bit of money if you want to start a business.



Jacques Stern
Accor
Group Chief Financial
Officer

Bjorn Hanson

The banks did not have to be as helpful as maybe it seems. If we go back to 1990-91, during the Gulf War, in North America 16.5% of hotel loans were in default. The banks were not very cooperative and ended up taking back through foreclosure many of those hotels. They learned that's a bad thing to do because they had to manage these hotels and make capital expenditures. This time, having had that experience, the banks did not want to take back the assets. Also the delinquency rate peaked in the first quarter of 2002 at only 5.5%. The industry managed itself through a severe crisis.

Malcolm Noden

The civil air transport industry has not done as well. We're seeing a heavy shift in the sector itself from one set of models to another set and great damage going on right now, including all sorts of bankruptcies. Different industries have different metrics.

Participant

What do think is the viability of different luxury brands like Louis Vuitton or Christian Dior extending their brand into boutique hotels and home ware and doing experience marketing as opposed to just commodity?

Jacques Stern

The Accor Group's Lenôtre is a deluxe caterer, well known in France, and we try to use this name in our hotels to bring image. If it can be done with Lenôtre, it can be done with Louis Vuitton. If we asked Monsieur Boulud to open a restaurant in our hotel, it can bring us both image—the only question is, "How is it running in terms of operation?" If Daniel asks me for a 5% franchise fee, I won't

do that, but if we share risk and reward, then it's a win-win situation. We can have brand and profitability

Mark Abramson

In addition to the Versace hotel, there are a number of other luxury hotels: Bulgari, Ferragamo, Armani. There's definitely a convergence between the two, like we see with the luxury goods in airports.

Anne de Louvigny Stone

I would like to present a medal created by our alumni association seven years ago to commemorate the 90th birthday of ESSEC. It is presented to those we most admire and individuals of exceptional character. Tonight we want to recognize our wonderful guest speakers and provide them with a reminder of their contribution to our Third Annual Newsmakers Panel.

*This summary is a free rendering of the discussion.
Only the underlined parts represent actual quotes of the discussion.*

Some news we received during the event

LATEST NEWS FROM ESSEC

Hervé Mathe
Director of Strategic
Planning, ESSEC



ESSEC is offering an attractive profile as a leading business school in Europe, with 4,500 students in degree-granting programs; more than 5,000 executives attending executive programs; 24,000 alumni in 50 alumni clubs in 35 countries; and more than 100 permanent faculty members and 300 adjunct faculty.

We have 100 BBA and MBA exchange programs worldwide with leading universities, and double degree MBA programs with Seoul National University, Beijing University, and Mannheim University. We also have a European MBA in partnership with Mannheim and Warwick Business School. Of course, we also have a joint hospitality management MBA program with Cornell: IMHI.

The fundraising campaign that started in 2002 may reach its objective earlier than planned. We could raise about EUR 25 million by 2006, small by American standards, but in Europe convincing donors to commit themselves to education is a new trend.

We have created and launched a series of sponsored chairs and are also expanding our facilities at the Cergy-Pontoise headquarters, whose buildings will probably double over the coming five years.

Another bracing challenge for ESSEC is fostering international recognition as a leading provider of business education and management research, not easy for an institution that has its roots in a traditional national system.

We launched two initiatives this year. First, with the University of Mannheim, we are deploying a redesigned joint executive MBA alliance program. Second, we opened a permanent Asian center in Singapore in conjunction with the Singapore Economic Development Board.

Other crucial objectives are to attract more North American students and faculty members and convince more North American companies to hire our graduates. How can we make our name famous in North America while still enhancing the principles and values deeply rooted in our European background? Your help could be of invaluable importance.

IMHI UPDATE

Nicola Pogson
Director Corporate
Relations, IMHI



IMHI stands for the "Institut de Management Hotelier International," and it became an MBA in 1988. When it was created in 1981, it was a pioneering joint venture that faced a number of obstacles, and we're very proud it's still there today.

Cornell and ESSEC both provide IMHI with curriculum input, teaching staff, and access to their network and resources. There is a student exchange, with students from each school able to study at the other for a semester (although we would like to see more students from Cornell). The IMHI diploma is co-signed by the two institutions and we've got 900 IMHI alumni.

I'd like to point out two of our partnerships. One is with Accor, who every year does a special program for a course at IMHI. In

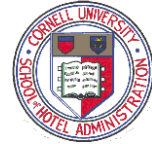
addition, IMHI runs executive management courses for Accor.

The second is with the Disneyland Resort, who gives two scholarships each year. We are also developing a theme park management course with them, which we hope to offer next year. We are also sitting on a board at Disneyland to develop a program to accredit professional experience among Disneyland professionals.

Finally, our students obviously want jobs when they come out, so if you're in hospitality, please see me.

CORNELL HOTEL SCHOOL OVERVIEW

Philippus Miller III
Director Alumni Affairs,
Cornell School of Hotel
Administration, Cornell
University



I work very closely with IMHI in collaboration with the Cornell Hotel Society, which has 60 chapters around the world reaching out to 10,000 Cornell Hotel School graduates. IMHI is a very collaborative organization. They help us so much in Europe and elsewhere (India, Asia), and I think we're able to add to their operations over here. It's certainly one of the biggest benefits of attending either school.

Cornell is well represented tonight, by a past president of the Cornell Hotel Society on the panel, Bjorn Hanson '73, and by CHS honorary member, Cornell faculty member and panel moderator, Malcolm Noden.

This summary was
prepared by
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REPORTING

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