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THE ROMANIAN TOURISM INDUSTRY DURING THE FINANCIAL CRISIS. AN INVESTORS' VIEW

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Abstract: *All over the world, investors seek the best placement of their money. They want high earnings, good liquidity, efficient protection of their investments and a favourable fiscal system. Under crisis conditions, they tend to be more vigilant and invest more carefully. The paper will focus on presenting the evolution of tourism industry in Romania and EU during the financial crisis and the investors' perception regarding the listed companies on the Romanian capital market.*

Key words: *tourism industry, financial crisis, capital market.*

1. Introduction

For any economy, allocating resources between various available investment opportunities is a critical issue, as all over the world, investors seek the best placement of their money; they want high earnings, good liquidity, efficient protection of their investments and a favourable fiscal system.

The decision to allocate financial resources for investment in a particular field and, more specifically, in a specific company, is based on multiple criteria, using indicators derived from a technical analysis and a fundamental analysis, respectively.

Based on these requisites, placement consultants, management consultants and investors would then want more details about:

- the evolution of the business environment and the evolution of the state's economic and fiscal policies;
- the structure and dynamics of the field where they prospect to invest;
- business strategies and development prospects for companies operating in that field;
- companies' capability to achieve specific financial targets (EPS, PER, etc.);
- possible business and/or financial risks (i.e. operational risks, risks coming from the financing structure and the dividend policy, liquidity risks, solvability risks, insolvency risks etc.);
- the ability of the management team to cope with challenges coming from the business environment.

In order to perform these analyses, investors monitor information available in their field of interest and try to find the market value of the targeted companies, in order to identify the best investment opportunities and, ultimately, the best gains.

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2. Valuating Tourism Companies for Investors

Valuation is the activity of estimating the value of tangible or intangible assets of companies or companies' shares. Valuation is a complex process, undertaken by highly specialized persons, the valuators that have vast knowledge in the economic and legal field.

Business valuation is very much welcomed by investors as it plays an important role in estimating the value of alternative business strategies and implementing programmes or the value of major transactions: mergers, acquisitions, disinvestments, recapitalisations, shares or bonds issues.

Generally, when carrying out a valuation of a company, the indications for the International Valuation Standards (Guidance Note) will be used, respectively GN1 – Valuation of Real Estate, GN 3 – Valuation of Plant and Equipment, GN 4 – Valuation of Intangible Assets, GN 5 - Valuation of Personal Property, GN 6 – Business Valuation, and GN 9 - Discounted Cash Flow (DCF) Analysis for Market Valuations and Investment Analyses.

Companies operating in tourism have specific particularities, triggering their specific valuation; therefore, along with the typical standards in business valuation, it is recommended to use especially the *International Valuation Guidance Note No. 12 - Valuation of Specialised Trading Property.*

Taking into consideration the provisions contained in these International Valuation Standards, valuating a company would entail the following:

- Identifying the company and the type of value to be estimated, according to the aim of the valuation;
- Making a preliminary analysis, collecting and selecting data about the internal and external environment of the business to be valued, its recent transactions, offers and demands for transactions;
- Building the SWOT matrix;
- Drafting hypotheses and limitative conditions;
- Estimating the value using the approaches recommended by IVSC, namely: sales, revenues and costs based approaches.

When starting the valuation of a company operating in tourism, it is essential to consider its structure, behaviour and performance paradigm, respectively: the offer and demand for tourist products, the structure of the company and market, the behaviour and performance of the company and market, the public policies in tourism.

An important category in tourism is represented by entities grouping hotels and restaurants that, in the IVSC's vision (along with other properties such as petrol stations, theatres, cinemas) are regarded as *properties assimilated with a company, Trade Related Properties (TRP)* or *distinct operational entities*. This paper will refer mainly to the investors' view regarding these types of tourism companies and will emphasize the particularities of their reasoning during the financial crisis.

3. The European Tourism Market during the Financial Crisis

International financial markets were strongly hit on September 15th, 2008 after Lehman Brothers, US's forth largest investment bank by assets, announced its bankruptcy. The Romanian capital system has been affected as well. On the Bucharest Stock Exchange (BSE), the descending trend started in September 2008 caused the aggregated index BET-C to drop to historical low levels (1231,05 points) last achieved in February 2003, marking a difference of 196,12% (see table 1).

BET-C variation Table 1

Date	BET-C	BET-C variation
10/09/2003	1231,92	-
09/15/2008	3645,46	+195,91%
02/25/2009	1231,05	- 196,12 %

Source: BVB

BET-C is the BSE's most representative index; it a composite index reflecting the evolution of the prices of the companies listed on the regulated market BSE (category I and II), excepting SIF-s (see figure 1). BET-C is a price index weighted by the market capitalisation of the companies included.

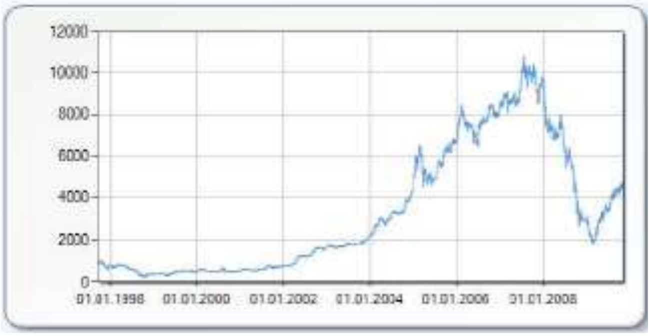

Fig. 1. *BET-C dynamic*

The sub-prime credits crisis started in USA affected not only the financial market but also many other areas, such as residential building, auto industry, textile industry, and also services, especially tourism.

A comparative study undertaken by CB Richard Ellis has revealed that, in the tourism industry in the CEE countries, the hotel occupancy rate during the entire 2007 year was between 60% and 80%, where the average daily rate (ADR) varied between 80 and 210 EUR, with markets classified in mature (Budapest, Prague, Vienna), stabile (Warsaw) or emergent (Bratislava, Bucharest). In 2008, the situation changed in that the occupancy rate dropped by 5% and ADR varied between 80 and 135 EUR (figure 2).

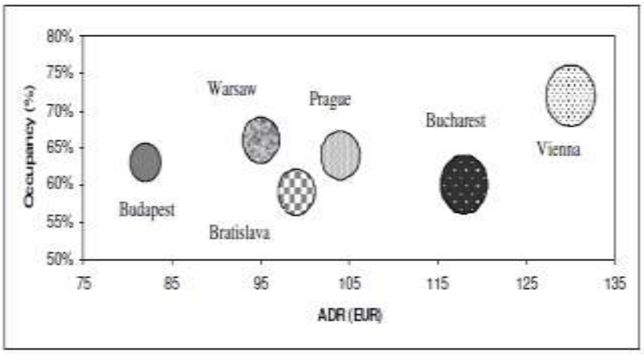

Fig. 2. *Occupancy and ADR for CEE hotels in 2008*
Source: CB Richard Ellis Report 2009

Compared with December 2007, in December 2008 the perception over the investment risk in CEE countries changed and, as a consequence, the expected return rate changed (see table no. 2). Naturally, such a change leads to a decrease in the market value of the transacted properties, the most severe correction being the one the Romania and the Czech Republic markets.

Prime yield for hotels with management contract 2007-2008 Table 2

City	Dec. 2007	Dec. 2008	Change
Bratislava	7,00%	8,00%	+1,00
Bucharest	**8,00%**	**9,25%**	**+1,25**
Budapest	6,75%	7,75%	+1,00
Prague	6,25%	7,50%	+1,25
Vienna	5,75%	6,50%	+0,75
Warsaw	6,50%	7,50%	+1,00

Source: CB Richard Ellis Hotels CEE

An international study published in The Magazine of the World Wide Hotel Industry for February 2008/February 2009 indicates that the Western European hotel industry is affected by the crisis (see table 3), with the occupancy, average daily rate (ADR) and revenue per available room (RevPAR) indicators showing significant decline; the most affected companies are located in Spain and Italy.

Performances of key countries in February 2009 vs. February 2008 Table 3

Country	Occu-pancy	% change	ADR (EUR)	% change	Rev PAR (EUR)	% change
Germany	55.2%	-7.4%	85.44	-0.7%	47.15	-8.1%
Italy	46.2%	-13.0%	115.70	-10.8%	53.50	-22.4%
Spain	52.1%	-16.2%	88.96	-6.4%	46.31	-21.5%
UK*	64.7%	-6.4%	77.13	-4.7%	49.90	-10.7%

Source: The Magazine of World Wide Hotel Industry 2009
ADR and RevPAR in GBP

Similarly, according to a study by the Cornell University (Kimes S. E. 2009) on a target group of 291 managers from the UK tourism industry, serious concerns have been expressed related to the future trends of industry, as the demand for renegotiation of the clients' contract increased, the involvement of the companies in price wars raised and the competition sharpened. Compared to 2008, when the main focus of the tourism companies was on attracting human resources and developing IT based support services in an expanding market, the year 2009 brought, in these managers' opinion, many difficulties in maintaining prices and a strong increase in the clients' negotiation power due to the dramatic decline of the demand during recession. A study by the European Travel Commission for Q4/2009 shows that the hotel industry in the whole Europe has been influenced by the financial crisis, with the hotels being unable to downsize their offer along with the decline in the demand and thus making losses. Nevertheless, the most critical losses have been seen in the eastern area of Europe, on the emerging markets.

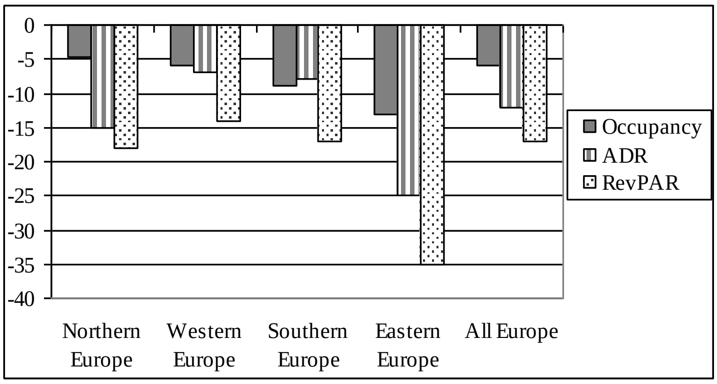

Fig. 3. *Hotel performance in Europe 2009*
Source: Tourism Economics, from STR Global Data

Estimations given by The Economist Intelligence Unit revealed an existing recession still for 2009 at a global scale, with improvements at global level to be seen only in 2010 (see table 4), but not for all the EU countries.

World statistics Table 4

	2007	2008	2009	2010
Real GDP growth				
World (%)	5.0	3.1	-0.8	2.2
Euro area (%)	2.6	0.7	-2.9	-0.2
EU27 (%)	2.8	0.9	-2.9	-0.2
Financial indicators				
EUR 3-month interbank rate (%)	4.27	4.65	1.90	1.90
USD 3 month-Libor (%)	5.30	2.41	0.54	0.94
Commodity prices				
Oil (Brent; USD/barrel)	72.7	97.7	40.0	50.0
Gold (USD/troy oz)	696.7	870.2	871.9	887.5
Food, feedstuffs & beverage (% change in USD terms)	30.9	29.6	-26.3	3.8
Industrial raw materials (% change in USD terms)	11.2	-5.3	-41.1	11.7

Source: The Economist Intelligence Unit

The financial crisis resulted in a brutal freezing of liquidities on a global scale and reduced considerably the appetite for investing in emerging markets. Despite the fact that it represented an engine for the economic development of the emerging markets during 2000-2008, the hotel industry in the CEE has been deeply hit by the financial crisis, with many cases of estate developers putting an end, postponing or delaying the real estate projects in tourism.

Harsher financial conditions have forced investors to focus on making the existing business more efficient, seeing that performance indicators were starting to decline.

4. The Romanian Tourism Industry Evolution during the Financial Crisis

In 2008, Romania's budgetary policy was expansionary, pro-cyclical and led to the accumulation of significant macroeconomic imbalances, manifested by a current account deficit and increasing inflation rate. The situation of public finances has deteriorated considerably in late 2008, the budget deficit reaching 4.8% of GDP, over twice the target set budget.

Romania suffered a decline in its economy during Q2/2008-Q4/2009, combined with changes in taxation, demands for amending the legislation on public servants' salaries, industrial actions, governmental instability, unemployment rise and significant increase in taxes and excises.

In 2009, the Romanian government introduced a lump sum tax for companies, causing the negative effects of the crisis on the private companies to worsen. Compared to 2008, the GDP dramatically dropped by 7,7% (according to National Forecasting Committee), and the international financial crisis affected the Romanian economy via a mix of channels. "We've identified five contagion channels of financial crisis' indirect effects in Romania: trade, financial, confidence, forex and effects over wealth and balances", said Mugur Isarescu, Governor of the National Bank of Romania (Isarescu, 2009).

Thus, on the trade channel, the exports' growth slowed down but so did the influx of foreign tourists. After two years (2007-2008) of strong growth in foreign tourists arrivals, data for the first eight months of 2009 showed a serious deterioration in the number of foreign visitors, by nearly -15% compared with the same period in 2008. Over this period, around 95% of all arrivals were from European countries (63% of visitors coming from the EU). Following the optimistic growth in Romanian tourist departures in recent years, official data for January-August 2009 showed a decline of 8% year-on-year of Romanian visitors abroad. But for 2010, a slight pick up in visitor arrivals to Romania is anticipated all together with the Euro zone economic recovery.

On the financial channel, the credit volume decreased and its cost increased, causing companies many problems and forcing them to adjust their business and investment plans. Thus, in Bucharest city centre, hotel investments planned by Sheraton, Meridian and Ramada Inn have been postponed or delayed. Likewise, other four projects for renovating existing premises (Boulevard, Swan, Golden Tulip and Starwood) have been delayed.

On the confidence channel, western European investors stepped back. This reduced the direct foreign investment influx (FDI) in most of the fields (according to National Bank of Romania). Thus, whereas in 2007 FDI amounted to a total of Euro 42.770 mil., and in 2008 to a total amount of Euro 48.798 mil., in the first 8 months of 2009, totals were only Euro 49.486 mils. (increasing only by 1,41% compared to precedent year).

Last but not least, on the channels of effects over wealth and balances, the net assets of the population and companies have deteriorated, as notably because of the many foreign exchange loans (linked with the RON's depreciation) and of the decrease in the price of the movable and fixed assets from speculative, non-sustainable values (*bubble* values). Such socio-economic events eroded the investors' confidence in the Romanian economy, as well as in the hotel industry, as shown by the evolution of the BSE index and P/BV and PER indicators starting with January 2008.

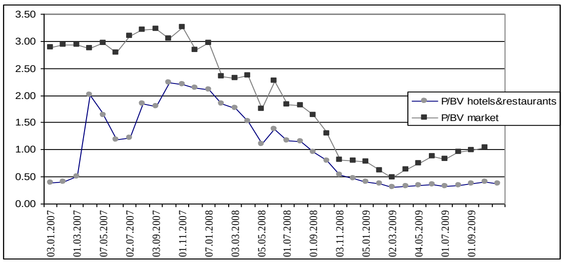

Fig. 4. *P/BV dynamic at BSE (2007-2009)*

Analysing the PER evolution, the indicator of a field or a company attractiveness for investors, a strong and positive correlation between the falling of the BSE and the decline in the hotel industry becomes visible, starting with January 2008, as well as a decrease in the market value of the tourism companies compared with the accounting value (fig. 5).

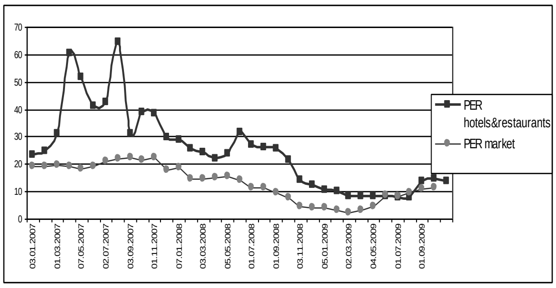

Fig. 5. *PER dynamic at BSE (2007-2009)*

An examination of the Bucharest Stock Exchange (BSE) reveals 3 listed tourism companies (symbol TUFE, EFO and BCM) – their evolution is presented in fig. 6, whereas on RASDAQ, although there are 45 listed companies, 20 of them resumed from trading and out of the remaining 25, 7 companies publish quarterly their financial situation and are relatively liquid (at least 1 transaction per week), 8 companies, even tradable, are not liquid (no transaction per year) and 10 companies do not publish their last financial situations (in the past 3 years), being very seldom traded.

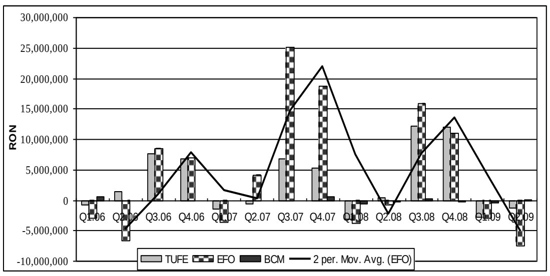

Fig. 6. *Dynamics of operational profit of the listed first tier hotel companies*

The evolution of all the listed hotel and restaurants companies shows a general decline in the field of profitability. Most of the companies made bigger losses in the first half of 2009 compared to the same period of the previous years which, combined with the politico-legislative instability, makes any attempt to forecast future incomes even harder.

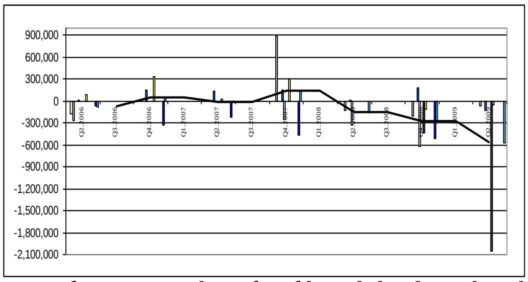

Fig. 7. *Dynamics of operational profit of listed third tier hotel companies*

When estimating the value, both for listed and unlisted companies, investors must take into account the evolution of both the Romanian and European economy and also the evolution of the tourism industry, in order to generate the SWOT matrix to use as basis for drafting the strategies for the future company's development, but also for the hypothesis and limitative conditions.

Similarly, the investor should consider the size of the turnover, total assets and employees, so that he/she can identify the most adequate market comparables.

In addition, when converting the income into a value, it is necessary to take into account that, in 2009, investors had an adverse risk perception, confirmed also by the high yields requested from the emerging markets (Romania is included – see table 2).

5. Conclusions

The International Monetary Fund called year 2010 as being the Year of Transformation and this can equally be applied to the world economy as well as to the tourism industry.

This analysis leads us to the conclusion that, from the investors' point of view, there will be three major problems that the tourism industry will have to face: the Romanian governmental policies in the fiscal domain, the perception regarding risks and confidence in Romanian and EU economies, and the ability of tourism companies to understand and to adapt their products to customers' needs, as there is an increasing trend from their part to search for a greater value for their money.

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