

Europe's grand hotel guardian

Leading Hotels of the World is a hotel reservation service that is defying the odds in the hospitality sector downturn. Whilst many top chains have to resort to raising capital by selling their properties, Leading is on target to amass a fund of €1 billion from private investors. Amazingly, it's using this to buy hotels. By Christian Sylt



Leading's chief executive Paul McManus has turned what was once purely a reservations company into a service provider for the luxury hotel market.

EUROPE IS home to the highest concentration of privately owned and managed hotels in the world. Prestigious properties such as Portofino's Grand Hotel Miramare, Vienna's Sacher hotel and Gstaad's Palace hotel have been in family hands for generations. However, like all independent hotels, these run the risk of being swallowed up by big chains should the owners' siblings not want to take the reins. But the death of independent hotels isn't upon us yet. A lifeline has been thrown from the unlikely source of Leading Hotels of the World, a reservation service that is buying properties in peril. And this is far from being marketing mumbo-jumbo. Leading spent a reported €20 million in August to buy its first hotel, the Cadogan in London, and is now set on snapping up 15 more over the next two years. As a rubber stamp of its seriousness, it says it will raise €1 billion to do so.

Leading spent around €100,000 to set up the Leading Trust, an investment vehicle comprising an open-ended fund which it created in partnership with New York-based real estate investment company Trinity Hotel Investors. And although Trinity's talents have been focused in the US, its few European forays have yielded a handful of high-profile investments such as the Hotel du Rhone in Geneva and the Hotel Rafael in Munich. But as independent hotels make up a much higher percentage of the total number of properties in Europe than they do in the US, the Leading Trust will give Trinity access to a fresh source of deals. Having already invested around US\$8.5 billion globally, Trinity has a top pedigree in the sector.

"Trinity's speciality is that they know the luxury hotel industry, which is a talent that transcends borders," says Paul McManus, chief executive of Leading. And McManus adds that although Trinity has a scout looking for investments from Leading's London office, the majority of the acquisitions should be in France, Italy and Switzerland.

Building the trust

The fund will be formed in three equal tranches. The first will be completed by the end of the year and is expected to have an investment of around €150 million. The following two tranches will then be completed in 2004 and 2005, with the remaining €550 million being leveraged against the acquired assets.

"The performance is based on 16

hotels," explains McManus. Four further deals are due to be completed by the end of the year, with two believed to be in France. Around eight are expected next year and three in 2005. However, McManus stresses that the trust won't only offer the opportunity for Leading to make outright purchases, but also the chance for it to take sliver equity in properties as well as partnership options, share swaps, asset management and capital advisory services. And whilst the fund isn't intended for development from scratch, he doesn't even rule this out for the future. But it's not just Leading itself which can take advantage of the fund as it's also accessible to the member hotels.

"The acquisition of hotels by the Leading Trust is the culmination of a five-year business plan for Leading to evolve from a hotel representation organisation to a service provider for the luxury hotel market sector," says McManus. This transition has been based on Leading establishing joint ventures in areas such as human resources, sales and marketing.

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Member hotels can maximise their membership revenue by using these services as they have been bespoke-created for the luxury hotel sector.

With Leading's reputation staked on its members, it's thus not surprising that one of its most crucial joint ventures offers quality assurance services so members can regularly test their standards to ensure they will survive Leading's stringent annual scrutinising. But, as McManus says, "if, for whatever reason, a Leading hotel is having difficulty maintaining standards, it can access capital through the trust to make necessary renovations." He adds that there's even a facility for wannabe Leading hotels to tap into the trust as part of their bid to become members. And this is the secret behind Leading's success at raising finance for the trust. Properties

bought by the trust are tied to Leading membership for an undisclosed period, which both bolsters and protects the company's main source of revenue.

Leading attractions

In the current economic climate, there are very few guaranteed revenue streams in the travel trade, but Leading is a rare exception. Its 400 members have a total of around 85,000 rooms and each member pays Leading an annual marketing fee of €280 per room (capped at 300 rooms per property) and a 'success fee' which amounts to seven per cent of reservation revenue. McManus says that in 2003, Leading "will drive almost US\$500 million in revenue to our hotels" and he explains that, in total, the fees levied by Leading amount to around a tenth of this. Although Leading operates an international reservation network with 18 offices worldwide, its limited associated overheads allow the company to enjoy healthy profit margins. Along with the capital coming in from members' fees, this has clearly charmed investors to the trust.

Although Leading's grand target of €1 billion is some way off, McManus says that the first funding tranche is on target and he reveals that investment is being raised from three sources. "One is an American investment fund, the second is a wealthy family and the third is an international investment bank," he says. And they're in it for the long term as little money is lost by investing in property, particularly buildings with an illustrious heritage. McManus expects that the trust should deliver an ROI of around 20 per cent although he stresses that this "varies according to the deal". However, he is adamant that Leading has picked the right time to invest.

Window of opportunity

"There is a window of opportunity right now in Europe to acquire very special assets at reasonable prices," says McManus. He illustrates this with the example of the recent dramatic changes to European banking valuations as hotel businesses are now valued for mortgage purposes on their cashflow, whereas previously they were valued on their asset base. Not only has this brought many independent hotels to the brink of bankruptcy but it has also sent the price of hotel properties plummeting.

"The residuals of some of the bad

M&A deals and consolidations of the last 10 years present another opportunity for us to look at," comments McManus. However, he stresses that in Leading's hunt for hotels for the trust, finding the right fit with its existing portfolio is a more crucial criteria than a capex level per property.

So McManus says the much-mooted break up of Le Méridien is unlikely to

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present an acquisition opportunity for Leading because the larger size of the properties makes them better suited to chains. "Our focus is on smaller, more deluxe opportunities as opposed to the large convention-type hotels," he explains. But with the boutique segment becoming more crowded and the recent ructions surrounding the fall from grace of Ian Schrager's Clift hotel, McManus clarifies that the hotels on Leading's hit-list are "not boutique but small".

Growth from within

McManus says that "most of the acquisition leads will come to us from within Leading," and with European hotels constituting some 48 per cent of its portfolio, it is not surprising that Leading expects to make its acquisitions in Europe. McManus further emphasises that the focus on European investments is "largely driven by the issues of succession", and he adds that as many owners may retire into the hotel community, it is preferable for them to sell to a company with which they have had a long and trusted relationship.

"Owners may not be amenable to bringing on an unknown equity partner or selling to a faceless brand," he says and adds that he is "very concerned" about eight to 10 family-owned hotels within Leading which could be subject to such forced sales. The trust can safeguard against this and McManus reveals that it is considering taking a 50 per cent stake in a hotel owned by four siblings, two of whom

want to sell their shares. To prevent conflicts of interest between Leading and its members, the trust cannot manage any hotels it buys. But although a management contract will always have to be found when the trust takes on a hotel, McManus says that there should be no shortage of candidates as preferential consideration will be given to the management groups within Leading. However, McManus stresses that the contract will "always be put out to bid through a request for proposal (RFP) process", although he adds that Leading "may select the company that is already operating the hotel if its performance is up to the required standard".

McManus says that Leading would look at acquiring a small chain through the trust. "We identified a family-owned asset that includes four hotels," he explains and adds that "had the trust been in existence at the time the Savoy group was sold to the US property firm Blackstone, we might have been in a position to bid for those assets". And no wonder he laments this loss as the Savoy slipped out of Leading's membership after being sold. And the group's five hotels would have been bringing in close to €250,000 in annual marketing fees alone. McManus is determined not to miss similar opportunities in future and highlights his "inside" information as also being a big attraction to investors in the trust.

Inside advantages

McManus says his close connections to Leading's member hotels gives him an opportunity to know about properties being placed on sale before they hit the market. "These are not hotels that will be promoted for sale by brokers; rather they are likely to be quiet, 'inside' deals," he says. This opens the door for Leading to offer an attractive price without being subject to market pressures and bidding competition and it is exactly how it acquired its first hotel, the 65-room Cadogan hotel in London for an estimated €20 million in August this year.

"The Cadogan deal was done through an intermediary," says McManus. "A friend called me and suggested we might want to look at it because of his relationship with the owner." Leading bought the hotel, with 40 years remaining on its lease, from freeholder Cadogan estates and the proprietor Richard Broyd, owner of four historic hotels. McManus admits that the deal took a year to put together and

explains that this was "longer than normal". Being Leading's first purchase, the company "wanted to make sure it was right", he adds, and because the building is listed, the Cadogan estate was concerned about Leading's plans for the property.

The RFP for the Cadogan attracted six candidates, says McManus. Leading selected Grace Leo-Andrieu, a French management company which has also worked on the famous Fregate island in the Seychelles as well as the regal hotel Royal Riviera in St-Jean Cap-Ferrat and the Lancaster in Paris. An extensive refurbishment of the Cadogan is already underway and the first phase, which includes two floors of accommodation, the bar and restaurant, will be completed by January 2004. McManus doesn't comment on the capital investment into the hotel but says he hopes that it will "perform at a significantly higher level both in terms of average rate and occupancy". And as the Cadogan is not yet a Leading hotel, its membership depends on these developments, which will be the first big test of the trust's impact in the industry.

Ironically, the greatest mark of the trust's success could be if it is able to sell some of the properties it has acquired for a profit as a result of their continued connection with Leading. And although

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McManus doesn't rule this possibility out, he assures that chains wouldn't be considered as buyers. However, many chains make up Leading's members and McManus comments that "the critical thing is that the hotel stays within the Leading portfolio."

Leading is in a win-win situation. The revenue stream from its members is attracting financing for the trust, which in turn will bring in more revenues from new members. Who said that selling hotels to raise capital was the only way to survive in the current climate?