OCT 2015

IN FOCUS:

MALAYSIA

FINDING THE SILVER LINING

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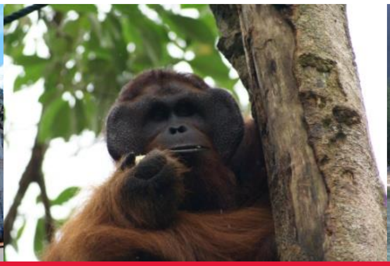



__The Federation of Malaysia__, located in Southeast Asia, comprises of Peninsular Malaysia and East Malaysia (on the island of Borneo), separated by the South China Sea. Malaysia covers an area of 329,758 square kilometres with 2,669 kilometres of land boundary and 4,675 kilometres of coastline. Tourism is the second largest foreign exchange generator in Malaysia after the manufacturing sector, accounting for 5.7% of direct and 14.9% of indirect contribution to the Gross Domestic Product (GDP) in 2014. Total contribution (both direct and indirect) to GDP is expected to grow by 4.5% per annum to Malaysian ringgit (MYR) 262.2 billion by 2025.

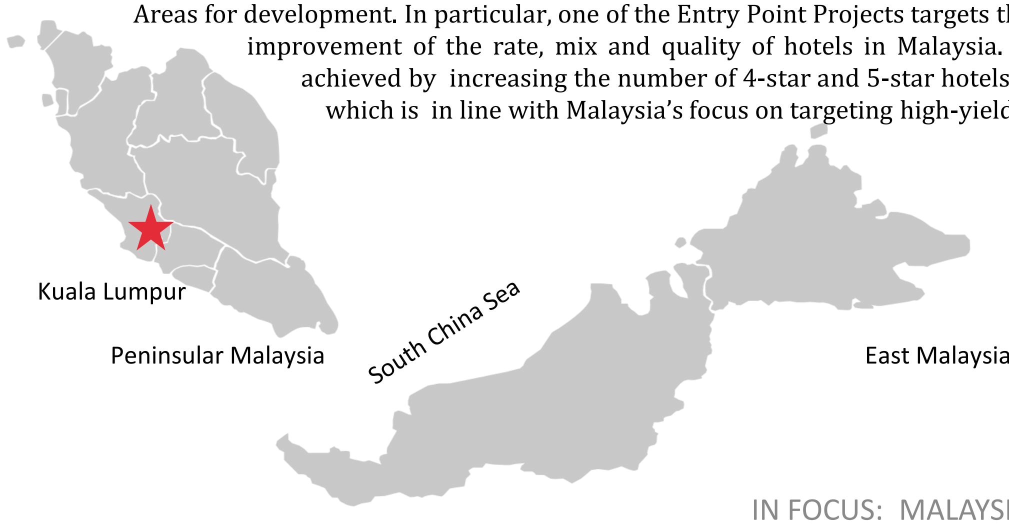
Malaysia was ranked the third top travel destination in Asia and the Pacific region, after China and Hong Kong, by the UNWTO World Tourism Ranking for the year 2014. Besides being an active business and meetings, incentives, conferences, and exhibitions (MICE) destination, Malaysia also depends on its diversified cultural/natural heritage sites and entertainment infrastructure to attract a considerable leisure market.

Economic Updates

Malaysia's economy showed a positive growth and posted GDP growth rates averaging 5.7% during 2010-13. In 2014, it achieved a 6.0% real GDP growth, reaching MYR1,106.6 billion. The GDP growth for 2015 is projected to slow down to 4.7% amidst a difficult environment for the global markets. The ringgit depreciated to a 17-year low against the US dollar. Nonetheless, based on robust economic growth and diversified investments from previous years, the economy fundamentals in the country can be considered sound.

The following events may have significant impacts on the prospects of the market in the short and long run:

- The drop in global crude oil price impacted Malaysia as an exporter of gas and oil products. It is estimated that the petroleum income tax and oil sector accounted for 21.2% of government direct tax revenue, which reflects 12.5% of total federal government revenue in 2014.
- The political uncertainty caused by corruption scandals, such as the case involving Malaysian state fund 1Malaysia Development Berhad (1MDB), which is still under investigation, may lead to civil unrest and potential delays in government projects.
- There is a general slowdown in the major regional economies, such as China, which is the largest trading partner of Malaysia. The moderation seen in these economies would impact the growth rate of Malaysia economy.
- According to the Economic Transformation Program (ETP), which aims to elevate Malaysia to developed-nation status by 2020, the government lists Tourism as one of the National Key Economic Areas for development. In particular, one of the Entry Point Projects targets the improvement of the rate, mix and quality of hotels in Malaysia. This can be achieved by increasing the number of 4-star and 5-star hotels in Malaysia, which is in line with Malaysia's focus on targeting high-yield tourists.



HVS

Tourism Market Overview

Malaysia has much to offer in terms of heritage, nature, culture and contemporary life. The worldwide marketing campaign called "Malaysia, Truly Asia", launched in 1999, was largely successful in improving tourism.

International Arrivals

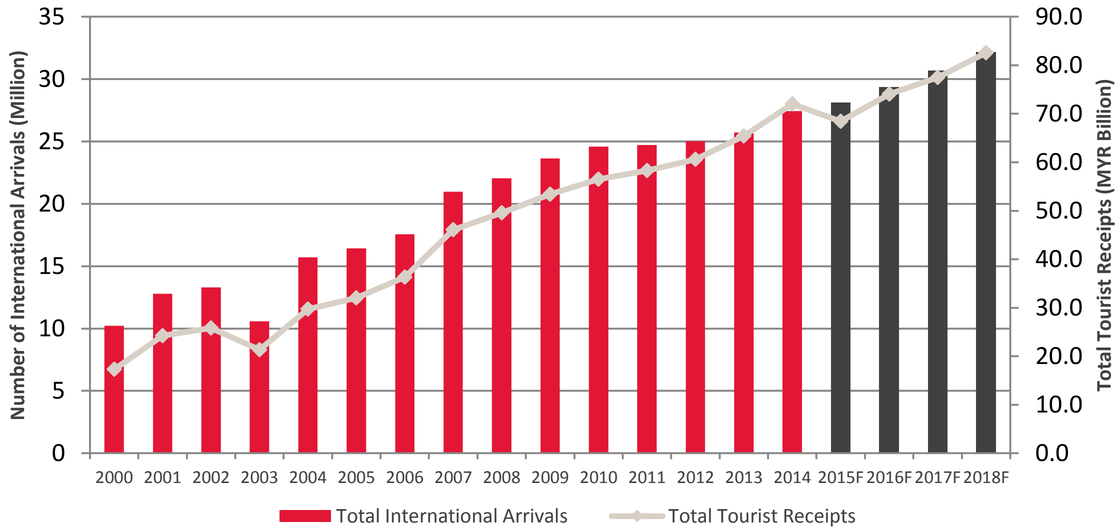
After a period of growth of tourist arrivals averaging 3.2% during 2009-13, Malaysia had a record year in 2014 with 6.7% growth; this was just short of the 28 million international tourist arrivals targeted by the national tourism campaign, Visit Malaysia Year 2014. Compared to 2013, tourist receipts increased by 10.0% in 2014.

However, the international tourist arrivals dropped by 8.6% in the first quarter of 2015 as compared to the same period in the previous year. The decline is largely due to a combination of internal and external issues such as the impact of the plane tragedies, the drop in arrivals from immediate source markets because of flooding issues in parts of Malaysia, and the increase in tourism competitiveness of other regional countries, for example, Japan and South Korea.

The international arrivals in the mid and long haul may be further impacted by the cut down in flight numbers by the Malaysian national carrier. In response to the plane tragedies in 2014 and its previously unprofitable expansion, the national carrier had to undergo restructuring in an effort to boost profitability. The restructuring saw its international seat capacity reduce by 18% from 307,000 in 2014 to 252,000 in September 2015.

As per estimates from leading agencies such as Euromonitor, Malaysia is expected to witness a steady growth of 4.5% per annum in international arrivals for the medium term till 2018. Considering the 25% cut in current national tourism promotion and advertising budget, Malaysia is expected to take a more targeted approach to promote travel from emerging key markets such as India and China.

FIGURE 1: INTERNATIONAL ARRIVALS AND RECEIPTS (2000-18F)

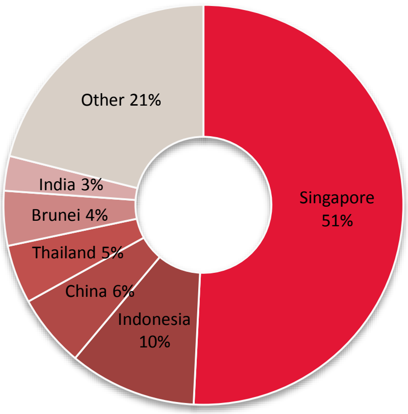


Source: HVS Research, Malaysia Tourism Office, Euromonitor

International Source Market

In 2014, ASEAN travellers make up 74.3% of all international visitations to Malaysia. Singapore was the largest international feeder market for Malaysia, contributing approximately 50.7% (or 13,932,967 arrivals) of all international arrivals. The low cost of goods and services in Malaysia and good connectivity via land and air attract multiple visits from Singaporeans. The proposed Singapore-Kuala Lumpur (KL) high-speed rail project (expected in 2020) and the Singapore-Johor Rapid Transit System (expected in 2018), will improve connectivity between Singapore and Malaysia.

FIGURE 2: MAJOR INTERNATIONAL SOURCE MARKETS (2014)



Source: Malaysia Tourism Office

Singapore, Indonesia, China, Thailand, and Brunei are the top five international source markets for Malaysia. China was the third major source market in 2014 and 1Q2015. However, Chinese arrivals experienced a sharp decline in 2014/2015, which is attributed to the loss in travel confidence owing to the three plane tragedies and the abductions of Chinese in Sabah. In an attempt to bolster travel from China, the Malaysian government implemented a visa fee waiver scheme (applicable from 15 February 2015 to 31 December 2015) for Chinese nationals; however, the success of this waiver can only be gauged at the end of this period.

Domestic Arrival

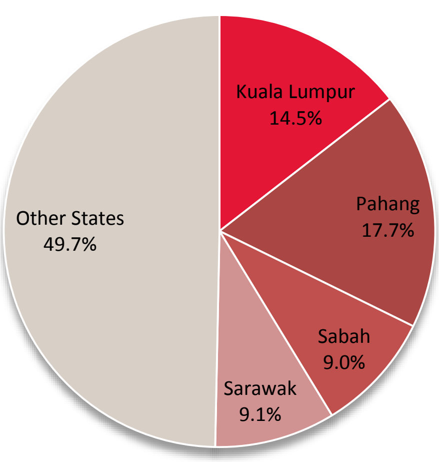
Domestic tourism is an important component of Malaysian tourism with nearly 90% of the domestic trips made for leisure purposes. The top four destinations for domestic travellers, based on 2014 figures, are the states of Pahang, Kuala Lumpur, Sarawak, and Sabah. Pahang accommodated eight million or 17.7% of all domestic stays in classified hotels while Kuala Lumpur followed close behind with 14.5% (6.6 million).

Domestic travellers are expected to be the main demand drivers in the next one to two years.

The growth in domestic tourism is not limited to the top four destinations, with the highest growth being recorded in Labuan (140.6%); the domestic travellers increased from 239,843 in 2013 to 577,120 in 2014. Selangor ranked second in domestic tourism growth rate with an increase of 53%, from 1,610,726 in 2013 to 2,466,995 in 2014. This positive growth bodes well for Malaysian tourism and maybe attributable to efforts in better promotional activities and upgrades in transport and tourism infrastructure.

Domestic travel peaks during school holidays in March, May and August while more outbound travel is recorded during the longer year-end holidays. Domestic travels' average length of stay has been recorded at three days, and these travellers tend to be more price sensitive than international visitors.

FIGURE 3: PERCENTAGE DOMESTIC HOTEL GUESTS ACCOMMODATED BY STATE (2014)



Source: Malaysia Tourism Office

Hotel Market Overview

Hotel Demand

The hospitality market in Malaysia witnessed approximately 71,666,295 hotel guests staying at properties across the country in 2014, of which nearly 63% comprised of domestic travellers. Commercial accommodations (hotels, bed & breakfast, etc.) are the top choice for international travellers to Malaysia with almost 96% of the arrivals utilising commercial accommodation in 2014.

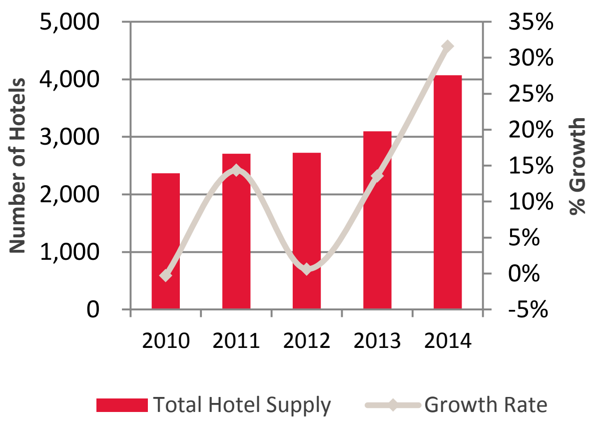
Although hotel demand in 2015 slowed down together with the drop in arrivals, the long-term demand for hotels remains resilient given that the country is still an attractive destination with several gateway cities such as Kuala Lumpur, George Town, and Johor Bahru. Previously, the Commercial and MICE travel segment was fuelled by large primary and secondary industries that specialised in oil and petroleum products. However, shifts may occur due to the weak performance in the oil market and the new drivers are expected to be from the financial and consumer products sectors.

The national tourism campaign in 2015, the Year of Festivals, focuses on festivals and exhibitions, promoting the attractiveness of Malaysia as a MICE destination in the South East Asian region. This is expected to induce demand for MICE and Leisure travel. Kuala Lumpur, in particular, is a vibrant MICE location in the region by virtue of good infrastructure, international connectivity, cost competitiveness and a wide array of facilities (convention centre, retail, F&B etc) and accommodation.

Financial and consumer products sectors are expected to drive Commercial demand.

Poor performance of oil and petroleum industry has indirectly reduced Commercial demand in the Malaysian hotel market.

FIGURE 4: MALAYSIA HOTEL SUPPLY (2010-14)



Source: HVS Research, Malaysia Tourism Office

Hotel Supply

In the hotels and rooms supply report by the Malaysian Tourism Office for the year 2014, a total of 4,072 classified hotels, which account for 262,021 rooms were recorded. During 2010-14, Malaysia's hotel supply grew by a CAGR of 14.5% in terms of hotels and 11.7% in terms of rooms. The states of Sabah (533 hotels), Johor (509 hotels), and Pahang (424 hotels) have the highest number of hotels in the country, with an average inventory of 60 keys.

Of the existing hotel supply (by number of hotels) in Malaysia, 22.7% is branded and affiliated with an international company while the rest comprises of independently run operations. The branded hotels are mostly located in Kuala Lumpur, along famous tourist attractions in coastal areas such as Langkawi, Penang and the key cities of East Malaysia such as Kota Kinabalu and Kuching.

Key New Openings by Year

2015

Hotel Name	Location
Dorsett Hartamas	KL
St. Regis	Langkawi
Lexis Suites	Penang
Novotel	Malacca
The Royale Chulan	Pahang

2016

Hotel Name	Location
St. Regis	KL
Banyan Tree	KL
The Regent Hotel	KL
Teluk Datai Development	Langkawi
St. Giles Southkey	Johor
Tabung Haji Hotel	Sarawak
UCSI Hotel Kuching	Sarawak
Semporna Resort	Sabah
Sulamanga, Sulaman	Sabah

2017

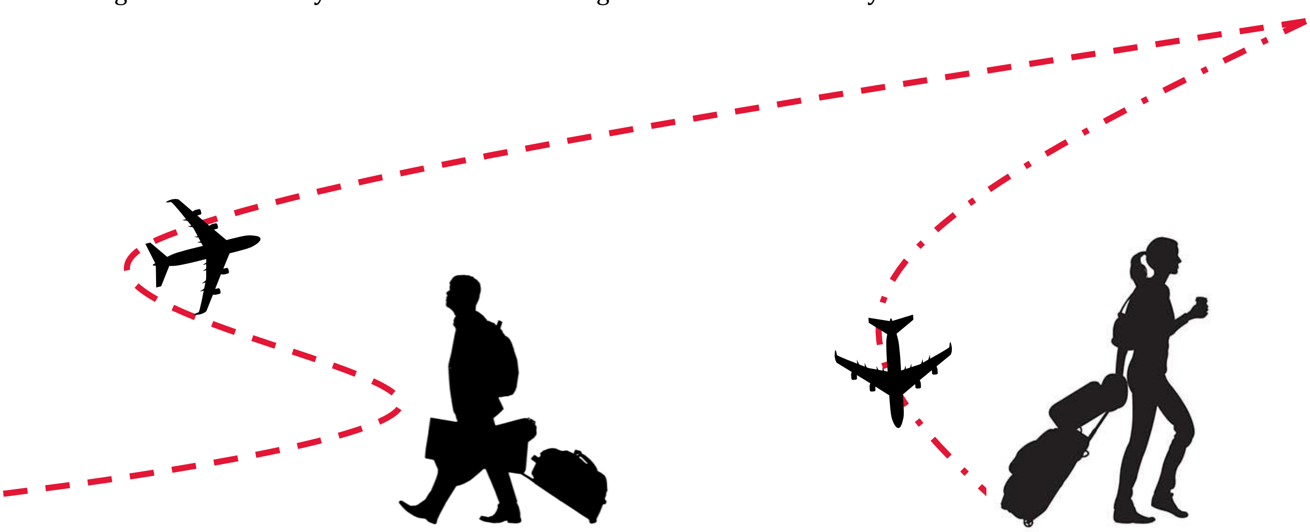
Hotel Name	Location
Fairmont	KL
Pullman	KL
Four Seasons	KL
PARKROYAL Resort	Langkawi
The Angsana	Penang
The Westin Desaru Resort	Johor
Alila Dalit Bay	Sabah

2018

Hotel Name	Location
Harrods @ Pavillion	KL
Courtyard by Marriott	Penang

Based on the hotels tracked across key markets, approximately 10,000 rooms is expected to enter the markets in the next three years. Key brand openings in the upscale and luxury segment will include the country's first Harrods hotel and the first Fairmont hotel along with brands such as the St. Regis, Banyan Tree, Westin, and the Alila.

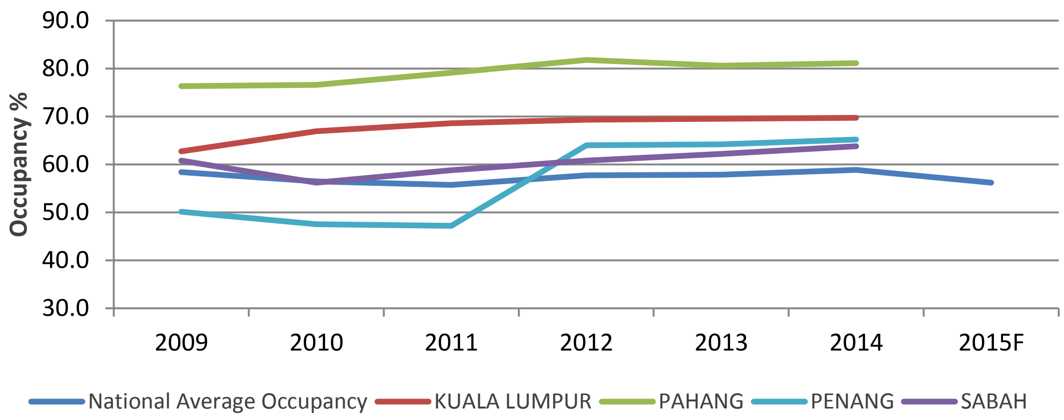
This is expected to lead to an increasingly competitive upscale and luxury hotel landscape, putting pressure on occupancy and average daily rate (ADR). However, these marquee developments are also expected to induce fresh demand into the market as they reach out to their core consumers across the globe in the luxury end of the consumer segment and market Malaysia as a destination to them.



Hotel Market Performance

Overall, market occupancy performance has fluctuated at 55-60% over the past six years with Pahang and Kuala Lumpur recording the highest occupancies in 2014 at 81.1% and 69.7%, respectively.

FIGURE 5: HOTEL OCCUPANCY RATE (2009-15F)



Source: HVS Research, Malaysia Tourism Office

Kuala Lumpur

As the federal capital of Malaysia, Kuala Lumpur is the financial, economic and cultural centre of the country. In 2014, it ranked among the top three Asian cities with the most number of international overnight visitors in the world, following Bangkok and Singapore.

The famous Golden Triangle region comprising of Kuala Lumpur City Centre, KL Sentral and Bukit Bintang is the key commercial, leisure and entertainment region in Kuala Lumpur. The 70-acre Tun Razak Exchange (TRX) development, located close to the Golden Triangle, aims to bring together a cluster of leading businesses to become the next leading international finance and business centre in Asia. Based on the TRX Master Plan, the development would consist of 25 buildings and over 21 million square feet of building gross floor area (GFA). It will offer a wide range of office, residential, retail, F&B space, and cultural sites. The project's lifestyle quarter is expected to feature a five-star branded hotel and three high-end serviced apartments. Although embroiled by the 1MDB scandal, the main investor in the project, TRX Phase I is expected to open in 2017.

Kuala Lumpur, an established Corporate and MICE destination, received 16,452,224 total hotel guests

destination, received 16,452,224 total hotel guests in 2014; of these, up to 60% constituted international guests. In fact, Kuala Lumpur is the top location in terms of international visitations (37.5% of all international visitors to the country). This may be attributed to the fact that it Malaysia's top international gateway city.

In 2014, the Ministry of Tourism had recorded 255 hotels or 38,916 available rooms in Kuala Lumpur. Based on HVS research on a sample set of approximately 15,000 branded rooms in Kuala Lumpur, hotel occupancy experienced a CAGR of 0.38% from 2010 to 2014, reaching 71% in 2014. However, in YTD May 2015, occupancy of hotels decreased by 8% points over the same period in 2014. Correspondingly, the sample set achieved an ADR of MYR380 in 2014, with a revenue per available room (RevPar) of MYR 270. However, the annual ADR is expected to decline by 12-13% by end-2015.

Looking ahead, based on the hotels referred to in this report, an estimated 2,200 hotel rooms are expected to enter the Kuala Lumpur market in the next three years. While the city hotels may witness some supply pressures in the short term, the emergence of key demand generators are expected to induce demand leading to a recovery.

Pahang

Endowed with many iconic tourism destinations such as the Genting Highlands, Tioman Island, Taman Negara and Cameron Highlands, the state of Pahang offers a wide range of leisure activities for both Domestic and International visitors. In 2014, Domestic travellers constituted almost 77% of all travellers to Pahang while Singapore (10%) and China (3%) constituted the top two source markets for International arrivals into Pahang. The demand in Pahang is expected to strengthen further as domestic tourism is expected to continue to grow.

Pahang enjoys the highest occupancy amongst all states, which is more than 20% above national average. Hotel occupancy achieved a CAGR of 1.2% from 2009 to 2014 with peak occupancy of 81.1% in 2014. However, it is noted that the average daily rate of classified hotels remains on the low end with unclassified hotels lowering the average rate.

Penang

Although Penang is a major industrial hub in Malaysia, it has numerous leisure attractions such as George Town, a UNESCO World Cultural Heritage Site, that cater to leisure travellers. Hotel demand in Penang is driven by almost the same proportion of Domestic and International travellers. However, Domestic travellers are more likely to be repeat visitors or make multiple trips to Penang. Hotel occupancy performed above national average and achieved a CAGR of 5.4% from 2009 to 2014, the highest growth rate among all states, and reached 65.2% in 2014.

Medical tourism is also highly significant in Penang, given that Penang receives almost half of all medical tourism patients arriving in Malaysia. A total number of 350,150 patients arrived in 2014, reflecting an increase of 3.65% from that in 2013.

The total medical tourism revenue experienced a positive growth in the past five years, reaching more than MYR419 million in 2014, an increase of 13% from 2013.

Sabah

Sabah, endowed with a rich diversity of natural sites, is a popular leisure destination. This includes Kinabalu Park, the first UNESCO World Heritage Site in Malaysia, which offers habitats varying from rich tropical lowland and hill rainforest to tropical mountain forest, sub-alpine forest and scrub on the higher elevations. Pulau Gaya, an offshore island and Semporna, a coastal town host a wide variety of pristine natural sights for nature and adventure travellers. The total visitor arrivals in 2014 to Sabah were 3.23 million and the total visitor arrivals increased by a CAGR of 5.8% from 2008 to 2014.

Sabah is mainly a domestic travel destination, with Domestic visitors making up to nearly 70% of total visitor arrivals in 2014. The total visitor arrivals in 2015 are expected to decrease by 10-13% as interest in the leisure market dampens largely due to occasional cases of abductions and the earthquake in June 2015. However, there is still great potential for Sabah to become the next eco-tourism and MICE destination in Malaysia in the long run.

Sabah has attracted considerable real estate investment in recent years due to the relatively positive economic outlook, abundant natural resources and lower property prices.

Total hotel supply recorded in 2014 amounts to 533 hotels with 26,456 available rooms. From 2009 to 2014, the hotel supply increased by a CAGR of 16%, the highest growth rate among all states. Hotel supply in the market lacks substantial international chain presence and higher positioned hotels; independent economy/mid-scale hotels and below make up 75% of the room supply. Going forward, nine classified hotels with 2,000 rooms are expected to enter the market in the next three years, with an average inventory of 220 keys. In terms of hotel performance, hotel occupancy in Sabah reached 63.8% in 2014 and grew with a CAGR of 1.0% from 2009 to 2014.

Hospitality Investment Market

Hospitality asset transactions and investments in Malaysia often involve properties located in and around Kuala Lumpur, given its key position as the economic centre of Malaysia. In more recent years, other states such as Penang, Sabah and Johor have also begun attracting investors' interest given their rise as leisure and commercial destinations.

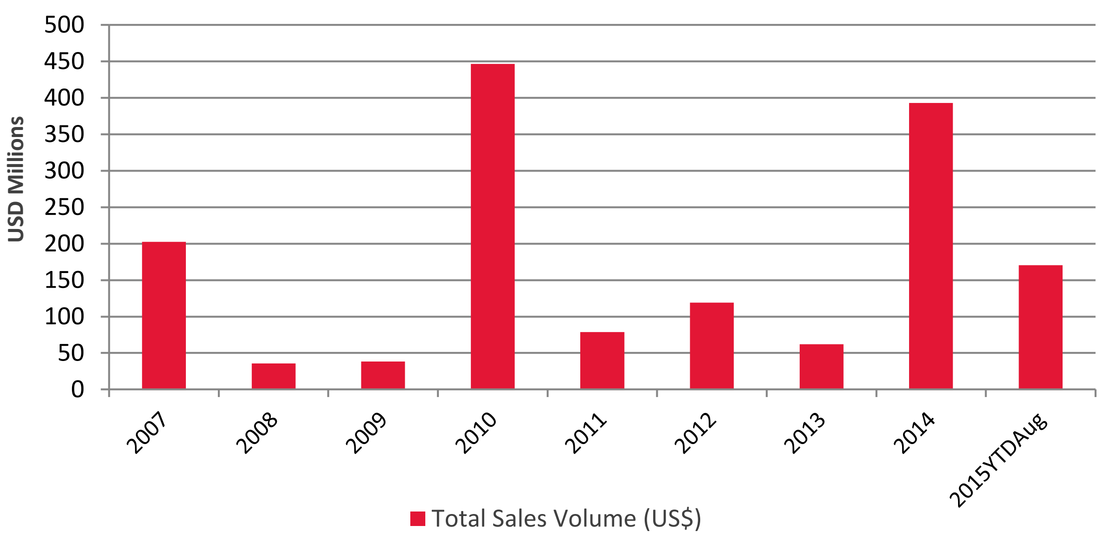
Based on recorded transactions, most of these investments have been made by companies based in Singapore such as Royal Group, Ascott Residence Trust and GSH Corporation; the proximity and familiarity with the Malaysian market being a major reason for these transactions. The total value of hospitality properties transactions from 2013 to 2015 was US$ 654 million and the average value was US$ 46.7 million.

Some key hospitality transactions include:

GSH JV TYJ Group bought the **Sutera Harbour in Kota Kinabalu** at US$275 million in 2014.

Royal Group bought the **DoubleTree By Hilton Kuala Lumpur** at US$105 million in 2015.

FIGURE 6: TOTAL INVESTMENT VOLUME (2007-AUG 2015 YTD)



Source: HVS Research, RCA

Finding the Silver Lining

Amidst the relative instability in the overall economic and political situation in the short term, recovery is expected in the mid to long-term horizon, given that the overall financial and political structure remains resilient. The weakening and volatility of the Malaysian ringgit is actually expected to encourage more domestic travel instead of outbound travels. In addition, international travellers may find it even more economical to visit Malaysia, hence, increasing their propensity to choose Malaysia as a more affordable destination.

Looking beyond the short-term downturn in market performance, Malaysia has the potential to develop diversified tourism products. In particular, it can make use of key resources and come up with themed travel packages such as heritage and culture, adventure and ecotourism, luxury and shopping, and wellness, spa and medical tourism.

Natural endowments in Malaysia place it at a natural advantage for developing new resort destinations beyond the usual tourist hotspots in the region. Given the emergence of eco-tourism, a sustainable use of natural landscapes in states such as Sabah and Sarawak would enable Malaysia to provide more leisure attractions. New amusement park additions such as the 20th Century Fox World Genting and Movie Animation Park Studios Perak (both expected to open in 2016) are also likely to garner interest among domestic and intra-ASEAN travellers.

Health and wellness tourism also displays high potential with more ASEAN residents choosing Malaysia as a more cost effective alternative compared to Singapore and Thailand. The Malaysian government continues to promote medical tourism, which has yielded positive results with an 11% current value sales growth in 2013, amounting to MYR2.9 billion in total sales.

Although the tourist arrival target of 29.4 million may not be achieved in 2015, the efforts put in for the Year of Festivals 2015 campaign are expected to pay off in the near future to promote Malaysia as a MICE destination.

The silver lining for Malaysian tourism and the hotel industry lies in the strength of the market fundamentals and investment in tourism infrastructure. Effective promotional efforts and better packaged tourism products may benefit future growth in the industry.

About HVS

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HVS SINGAPORE team has worked on a broad array of projects that include economic studies, hotel valuations, operator search and management contract negotiation, development strategies for new brands, asset management, research reports and investment advisory for hotels, resorts, serviced residences and branded residential development projects.

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