BANK OF GEORGIA RESEARCH

Georgia's Tourism Sector

Seize the Opportunity

Georgia | Tourism
Industry Overview
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Terms and Definitions

ACT – Analysis and Consulting Team
CAGR – Compound Annual Growth Rate
CEE – Central and Eastern Europe
CIS – Commonwealth of Independent States
CPI – Consumer Price Index
FDI – Foreign Direct Investment
FTZ – Free Tourism Zone
GCAA – Georgian Civil Aviation Agency
GDP – Gross Domestic Product
GeoStat – National Statistics Office of Georgia
GNIA – Georgian National Investment Agency
GNTA – Georgian National Tourism Administration
MESD – Ministry of Economy and Sustainable Development of Georgia
MICE – Meetings, Incentives, Conferencing, Exhibitions
MoF – Ministry of Finance of Georgia
MRDI – Ministry of Regional Development and Infrastructure of Georgia
NAPR – National Agency of Public Registry
NBG – National Bank of Georgia
PPI – Producer Price Index
T&T – Travel & Tourism
TAV – Tepe Akfen Ventures
UNESCO – United Nations Educational, Scientific and Cultural Organization
UNWTO – United Nations World Tourism Organization
USSR – Union of Soviet Socialist Republics
VAT – Value Added Tax
WB – World Bank
WTTC – World Travel & Tourism Council

Domestic Tourism Survey – Final Report (III Wave) is a survey conducted by ACT for GNTA for the period of December 2011 – April 2012

International Visitor Survey – Wave II + III + IV + V Report is a survey conducted by ACT for GNTA for the period of July 2011 – April 2012

Executive Summary

Before heading off on adventure, prospective travelers typically search the web for the top things to do in a given country. Less than a decade ago, many travelers would have been impressed by Georgia's long history and rich culture but turned off by poor infrastructure and services. Georgia has since drastically improved accessibility and services, as well as the safety of attractions. Tourism is not a new concept for Georgia, rather a recollection of what it once was. During the Soviet period in late 80s, the country of then just 5.3mn (official statistics estimates current population at 4.5mn) hosted over 3mn visitors annually, including 250,000 from outside the USSR. The collapse of the Soviet Union and the ensuing unrest brought Georgia's tourism to a standstill and the number of visitors slipped to around 383,000 in 1999, with most coming from the CIS[1].

Since then, Georgia posted an impressive 22% CAGR in visitors over 2000-2012. The Lonely Planet travel guide recently named Georgia one of its top-10 Best Value Destinations for 2013. As the world steadily rediscovers Georgia as a real tourist destination, we believe the hospitality sector holds attractive investment opportunities. This is especially true for accommodation as the segment is already starting to see a shortage.

International benchmarks point to significant growth prospects. The number of international arrivals (international visitors who cross the national borders of Georgia with foreign passports) to Georgia was up 56% y/y, reaching 4.4mn in 2012 and we expect around 4.8mn in 2013. We have observed that tourist destinations that are in the development stage demonstrate growth for at least 10 years. We have used this approach for Georgia, taking 2009 as the base year for our forecasts. We believe, Georgia is on pace for 5.7mn international arrivals by 2015 and 8.2mn by 2019, or 1.3x and 1.9x the country's population in respective years. In 2010, Croatia, Cyprus, Montenegro and Estonia hosted 2.1x, 2.0x, 1.7x and 1.6x of their respective populations.

The projected growth will soon flush out a major constraint – a shortage of accommodation units. International brands, including Marriott, Radisson, Holiday Inn, Sheraton, and Citadines, stormed the Georgian market in recent years and additional international projects are slated for 2013-2015. Despite the mass entrance, our base case shows that Tbilisi and Batumi are likely to reach capacity constraints in terms of accommodation units in the next several years. Data suggest that Georgia's current room capacity is significantly lower than in peer countries like Slovenia, Croatia, Cyprus, Estonia, Latvia, Lithuania, Montenegro, etc. With tourism on the rise and a shortage of rooms and beds looming, the timing for hotel development projects looks right as new facilities would likely come on-stream in time to meet rising demand.

Branded mid-scale and branded budget hotels are a priority in Tbilisi and Adjara, as their share is projected to grow at a faster pace. Tbilisi and the Black Sea coast are leading the way in tourism thanks largely to business, leisure and gaming tourism. A key survey shows that only 27% of international arrivals stay in hotels, mainly on business and leisure. In our view, the share of leisure and recreation tourism should rise significantly over the mid-term, reaching 64% by 2019. We believe Georgia could see 3.4mn and 5.2mn of leisure and recreation arrivals by 2015 and 2019, respectively. As for business travelers, we assume their share in total international arrivals will be around 13% by 2019. Global tourism trends show that leisure and recreation travelers are mostly drawn to branded mid-scale and branded budget hotels, while business travelers tend to stay in branded mid-scale and up-scale hotels. Tbilisi accommodation market is relatively undersupplied with a room penetration ratio of 0.67x, some 33% lower than in other select cities.

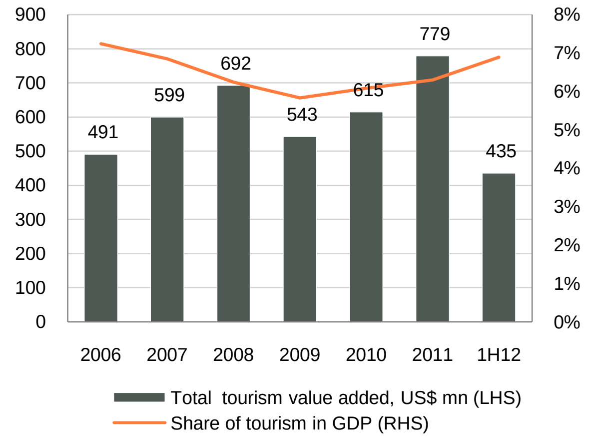
[1] In this paragraph, we have used media sources, as we could not identify the official statistics on the number of visitors to Georgia during the Soviet and early post-Soviet period.

Tourism Sector Overview

Travel and Tourism (T&T) contribute significantly to the global economy. According to estimates from the World Travel & Tourism Council (WTTC), the sector's total contribution to global GDP and employment were 9.1% and 8.7% in 2012, respectively. The sector's direct contribution to global GDP and employment has remained stable over the past several years, making up 2.8% and 3.3% in 2012, respectively. In recent years, the global economic turmoil impacted the sector, with international arrivals down 4.3% and international tourist receipts down 10.4% in 2009, falling from a 2008 peak. Signs of recovery emerged in 2010 as international arrivals and spending returned to pre-crisis peak levels and grew 6.5% y/y and 8.2% y/y, respectively. According to UNWTO, international tourism has reached over 1bn international arrivals in 2012. The industry is expected to grow by an average of 4% annually over the next ten years, which translates into 10% of global GDP or about US$ 10tn.

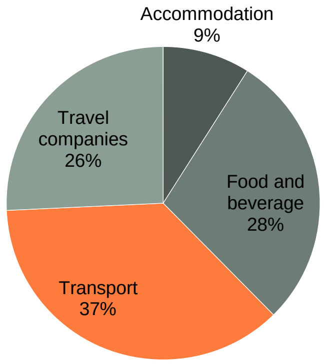
Tourism contributed 6.9% to Georgia's GDP in 1H12 and 6.3% in 2011, with transport, food and beverage and travel companies making up 91% of tourism-related services in 1H12.

Figure 1: Share of tourism in Georgia's GDP



Source: GNTA

Figure 2: Composition of tourism-related services, 1H12



Source: GNTA

The tourism sector is a complex beast that encompasses numerous sub-sectors that impact, often significantly, other sectors.

Table 1: T&T's contribution to GDP and employment

Direct T&T contributions

Commodities
- Accommodation
- Transportation
- Entertainment
- Attractions

Industries
- Hotels & Catering
- Retail
- Transportation services
- Business services

Sources of spending
- Residents' domestic T&T spending
- Business' domestic travel spending
- Visitor exports
- Individual government T&T spending

→

Indirect T&T contribution
- T&T investment spending
- Government collective T&T spending
- Impact of purchases from suppliers

→

Induced contribution (spending of direct and indirect employees)
- Food and beverage
- Recreation
- Clothing
- Housing
- Household goods

→

Total T&T contribution
- To GDP
- To employment

Source: "Travel & Tourism's Economic Impact 2011" by WTTC

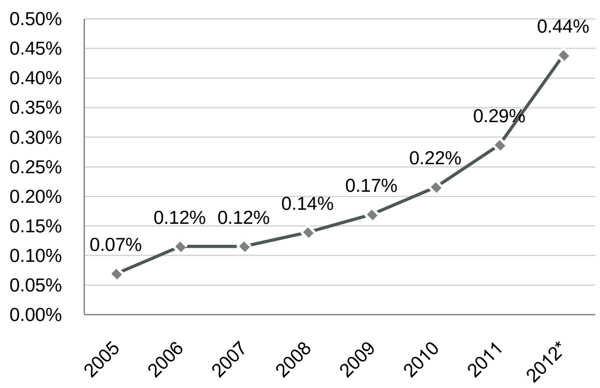
Bucking the global trend, international arrivals rose in Georgia through the global economic crisis. In 2008, while the world was dealing with the financial and economic turmoil and despite Georgia's short armed engagement with Russia in August, the number of arrivals continued to grow. The most likely driver, in our view, was the increase in diplomatic and other missions following the conflict. The trend continued into 2009 with international arrivals up 16.3% y/y and receipts growing 6.5% y/y, prompted by regional tourism. Share of international arrivals to Georgia in international arrivals worldwide has also been on the rise, reaching 0.44% in 2012.

We believe Georgia's visa regime liberalization since 2005 spurred the growth of international arrivals in later years. Georgia currently has no visa restrictions for visitors from over 80 countries.

Figure 3: International arrivals and tourism receipts, Georgia

Source: GNTA, NBG

Figure 4: Share of international arrivals to Georgia in arrivals worldwide

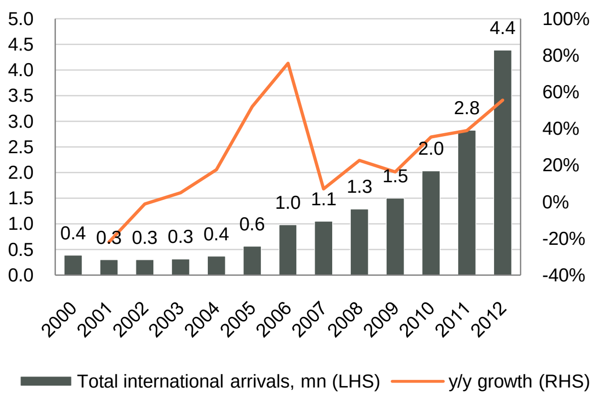


**Preliminary data*

Source: WB, GNTA

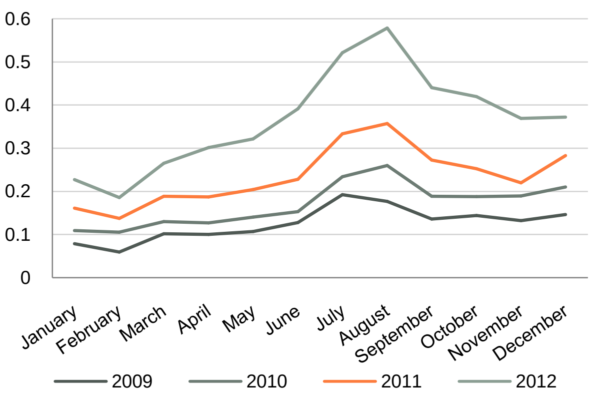
The number of international arrivals to Georgia was up 56% y/y, reaching 4.4mn in 2012 and we expect around 4.8mn in 2013. Georgian tourism activity usually peaks in July and August. International arrivals y/y growth rate has been sustained throughout 2012, with the number of international arrivals up 54% y/y in 4Q12.

Figure 5: Total international arrivals by year



Source: GNTA

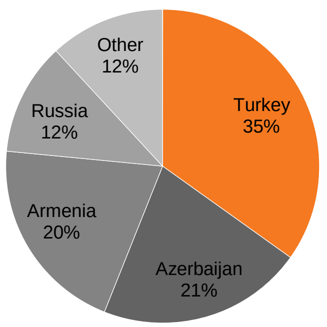
Figure 6: International arrivals trend in Georgia, mn



Source: GNTA

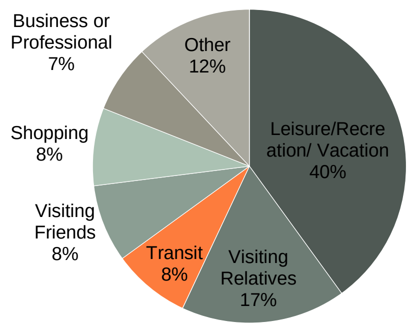
Neighboring countries account for most of Georgia's international tourism. Visitors from Turkey, Azerbaijan and Armenia make up 76% of international arrivals. Visitors traveling to Georgia for leisure and recreation make up 40% of international arrivals. The largest increase in international arrivals in 2012 came from Turkey (up 107% y/y) and Russia (up 83% y/y).

Figure 7: International arrivals by country of residence, 2012



Source: GNTA

Figure 8: International arrivals by purpose of visit



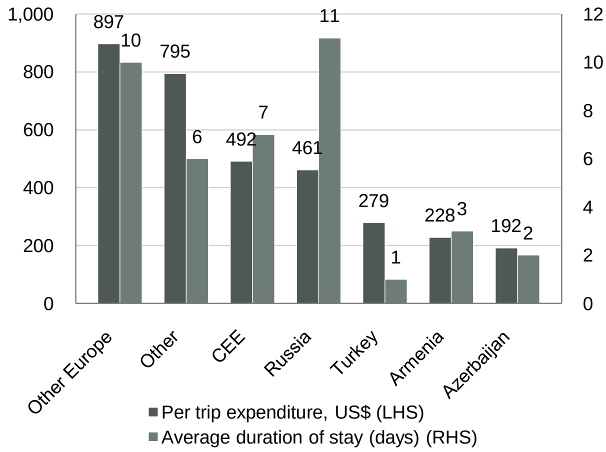
Source: International Visitor Survey conducted by ACT for GNTA

Road travel is the most popular (84%). As of 2011, only 12% arrived by air, while travelers by sea and rail accounted for 2% each. We believe that 2012 has experienced no significant change in the distribution of arrivals by the mode of transport. The dominance of the road transportation is largely due to the fact that most of the visitors come from Azerbaijan, Armenia and Turkey (which borders Adjara, located on the Black Sea coast).

Russian and European visitors stay the longest and the latter have the highest per-visitor spending. Business and leisure travelers stay the longest at 4 days on average. Thanks largely to per diem rates, business travelers also tend to spend the most. Unlike those visiting friends and family, business travelers spend on accommodation, food, entertainment, etc.

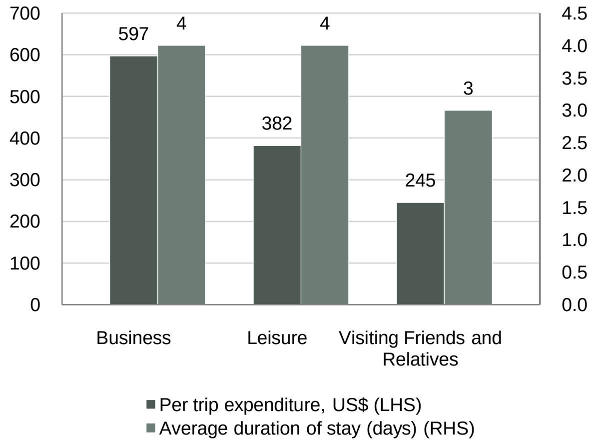
Visitors from Turkey, Azerbaijan, and Armenia have the shortest duration of stay. Over one-third of those visitors do not spend the night in Georgia. Per-visitor spending from these countries also seems to be the lowest. By purpose of visit, those visiting friends and relatives have the shortest duration of stay (3 days) and the lowest per-visitor spending.

Figure 9: Spending, duration of stay in Georgia by regions



Note: Please see the additional details in the footnote [2]
Source: International Visitor Survey conducted by ACT for GNTA

Figure 10: Spending, duration of stay in Georgia by purpose of visit



Source: International Visitor Survey conducted by ACT for GNTA

[2] *"Other Europe": Austria, Belgium, Croatia, Denmark, Finland, France, Germany, Greece, Ireland, Israel, Italy, Malta Norway, Netherlands, Spain, Sweden, Switzerland and the United Kingdom.*

"Other": Afghanistan, Africa, Albania, Arab Republic, Argentina, Australia, Bangladesh, Brazil, Canada, China, Egypt, Ethiopia, Ghana, Guyana, India, Indonesia, Iran, Iraq, Japan, Lebanon, Malaysia, Mexico, Nepal, New Zealand, Nigeria, Pakistan, Philippines, Qatar, Republic of Korea, Saudi Arabia, South Africa, Sri Lanka Syrian, Taiwan, Thailand, United Arab Emirate, and United States.

Future Trends and Forecasts

International arrivals will grow by 1.9x over the next 7 years, by our estimates. We project 5.7mn international arrivals by 2015 and 8.2mn by 2019.

To forecast growth, we used multiples of total arrivals to population of select countries. By holding population numbers constant, we derived the y/y growth and calculated the mean of geometric average growth rates to receive a single trend line. We have chosen Bulgaria, Croatia, Cyprus, Estonia, Latvia, Lithuania and Montenegro as peers to Georgia. We have included Montenegro (which, relative to other peers, has posted an extremely high average population multiplier growth rate) in our estimates due to the country's similarities with Georgia. Both countries have import prevailing and trade oriented economies. Montenegro, like Georgia, is a small country offering sea and mountain tourism. Both countries generate nearly equal income from international tourism, however, the number of international arrivals in Montenegro is half the number of arrivals in Georgia. The essential difference between the peer countries and Georgia is the proximity and accessibility of European markets for the majority of the peer countries.

Based on visitor numbers and qualitative data, we believe that Georgia is entering the sector development stage. International examples suggest this stage – all else being equal – should last at least 10 years. We have taken 2009 as the base year for Georgia, when it started to post stable growth in international arrivals. Georgia's 4.4mn arrivals in 2012 translate into a current population multiplier of 1.0x. By applying the average multiplier growth rate of the selected peers to Georgia from 2013 to 2019, we project the number of arrivals to hit 8.2mn in 2019, or a population multiplier of 1.9x.

Table 2: International arrivals, forecast

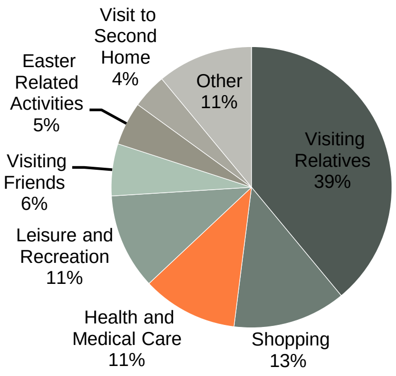
Implied growth rate of 6.5%	2012	2013	2014	2015	2016	2017	2018	2019
Multiplier	0.99	1.08	1.19	1.31	1.43	1.57	1.73	1.90
Number of international arrivals, mn	4.39	4.79	5.22	5.70	6.26	6.78	7.44	8.17

Note: The multiplier growth rates are based on past multiplier growth rates of peer countries
Source: GNTA, BoG Research

We believe that the number of international arrivals in Georgia will continue its upward trend. In the past years, many reforms have been implemented to promote tourism including the liberalization of the tax system, the simplification of licensing and other administrative procedures and the easing of the requirements for entering the country, among other measures. Going forward, the increasing number of cheap airlines and frequency and direction of flights should positively affect visitor inflow, in our view. Moreover, there are an increasing number of tourist destinations, which makes traveling in Georgia more appealing to international as well as domestic visitors.

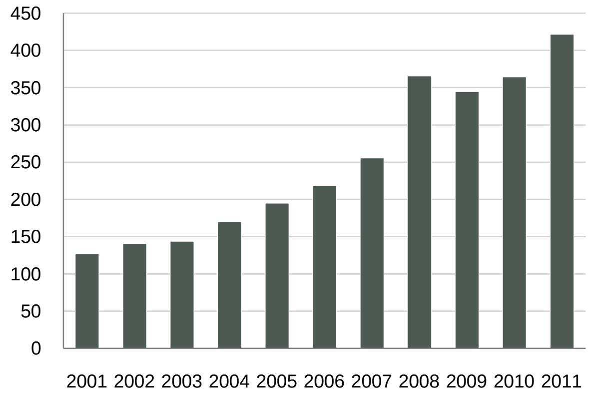
Domestic tourism is becoming increasingly important along with the growing monthly income of Georgia's population. The average monthly cash and non-cash income of the total population increased 3.3x since 2001 to US$ 421.8mn in 2011. Based on the *Domestic Tourism Survey,* Georgia had up to 2.3mn of domestic visitors, the majority visiting the capital and originating from villages. Domestic visitors mainly travel to visit friends and relatives and stay an average of 2 days.

Figure 11: Domestic visitors by purpose of visit



Source: Domestic Tourism Survey conducted by ACT for GNTA

Figure 12: Average monthly income of Georgia's population, US$ mn



Source: GeoStat

We believe that domestic visitors travelling on leisure and recreation are most likely to stay at accommodation units. According to the *Domestic Tourism Survey*, 11% of the total number of domestic visitors, or up to 251,000 visitors, traveled for leisure and recreation. We expect this number to grow in line with the real GDP growth rate, which translates into 1.1mn domestic visitors by 2019, on our estimates.

Unlike domestic tourism, the number of outbound tourists for the same period was significantly lower, at only around 172,000 residents (please note that the number of domestic and outbound visitors refers to number of individuals while the number of international arrivals refers to number of visits). The purposes of outbound tourism were: visiting friends and relatives (28%), shopping (25%), leisure and recreation (14%), employment (10%), and other (23%). The most popular destinations were Turkey (45%) and Azerbaijan (24%).

Share of leisure and recreation travel among international arrivals will rise over the mid-term, in our view. Travel for leisure and recreation accounted for 40% of total international arrivals and travel for shopping purposes accounted for 8% of international arrivals in 2011. We expect the share of leisure and recreation travelers along with those visiting for shopping purposes (together accounting for 48% in 2011) to post 11.4% CAGR over 2012-2019 and increase to 64% by 2019. We estimate that business travel will post 8.3% CAGR over 2012-2019 and hold 13% share by 2019. These two categories are likely to use hotel accommodation facilities while travelling. Business and leisure visitors tend to stay the longest in accommodation units and spend the most.

Table 3: International arrivals by purpose of visit

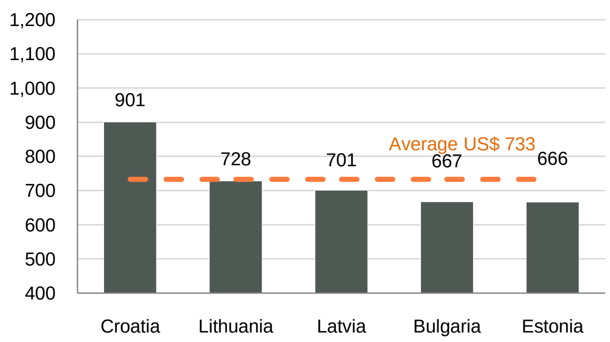
	2012E*	2013F	2014F	2015F	2016F	2017F	2018F	2019F
Number of international arrivals, mn	4.39	4.79	5.22	5.70	6.26	6.78	7.44	8.17
Leisure / Recreation / Vacation[1]	2.46	2.74	3.05	3.39	3.81	4.18	4.68	5.23
growth	*na*	*12%*	*11%*	*11%*	*12%*	*10%*	*12%*	*12%*
Share in total	*56%*	*57%*	*58%*	*60%*	*61%*	*62%*	*63%*	*64%*
Business / Professional	0.59	0.64	0.69	0.75	0.81	0.88	0.95	1.03
growth	*na*	*8%*	*8%*	*8%*	*8%*	*8%*	*8%*	*8%*
Share in total	*14%*	*13%*	*13%*	*13%*	*13%*	*13%*	*13%*	*13%*
Visiting Friends and Relatives	0.81	0.83	0.86	0.88	0.91	0.94	0.96	0.99
growth	*na*	*3%*	*3%*	*3%*	*3%*	*3%*	*3%*	*3%*
Share in total	*18%*	*17%*	*16%*	*15%*	*15%*	*14%*	*13%*	*12%*
Other (incl. healthcare)	0.53	0.58	0.62	0.67	0.72	0.78	0.85	0.91
growth	*na*	*8%*	*8%*	*8%*	*8%*	*8%*	*8%*	*8%*
Share in total	*12%*	*12%*	*12%*	*12%*	*12%*	*12%*	*11%*	*11%*

[1]Includes visitors arriving for leisure, recreation and shopping purposes
**Due to the lack of sufficient data on the arrivals' purpose of visit, the breakdown for 2012 is estimated*
Source: BoG Research

We believe that share of higher-yielding visitors will gradually increase with growth in non-neighboring tourism. The development of Georgian tourism is currently more reliant on lower-yielding visitors rather than higher-yielding ones. We believe this is natural as the sector is early in its development cycle and is only just establishing itself as a new destination. As Georgia promotes itself as a destination, the increase in the share of non-neighboring countries should boost average per-visitor spending. The share of international arrivals from Europe (excluding CIS) has gone from 32% in 2011 to 40% in 2012. Moreover, the sector has started to increasingly diversify beyond the basic food and accommodation services, which should also result in an increase in average spending. The increase in MICE, gaming, business and cultural tourism should also increase per-visitor spending gradually. The world is starting to take notice of Georgia – the Lonely Planet named it one of its "10 Best Value Destinations" for 2013.

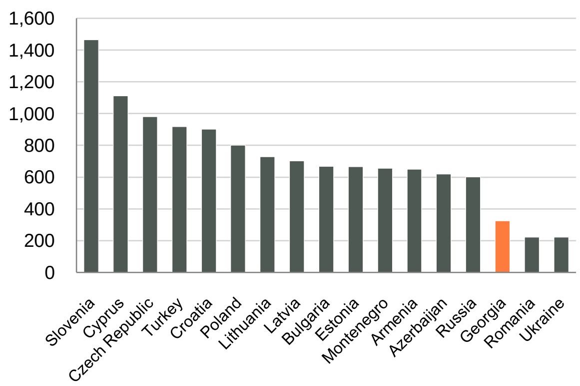
The charts below show average spending by peer groups. The average visitor to those potential peers spends US$ 733, double that of average visitor spending in Georgia.

Figure 13: Visitor spending for Georgia's peers, US$/visitor, 2010



Source: WB

Figure 14: International tourism receipts, US$/visitor, 2010



** Data for Armenia and Romania were taken from 2009 as there was insufficient information for 2010*
Source: WB

Georgia has a strong potential to develop year-round tourism. Georgia boasts a large diversity of cultural attractions, including 12,000 historical and cultural monuments, four of which are included on UNESCO's World Heritage List, 103 resorts and 182 resort areas, 8 national parks and 2,400 mineral water springs. A varied topography and climate, as well as the Georgia's commitment to develop the tourism sector, bode well for the development of year-round tourism, in our view. We expect the current geographical concentration to diversify into other regions as leisure tourism, namely wine and food, eco and culture tourism continue to gain popularity. Gaming and MICE tourism also offer a strong opportunity for year-round tourism. Domestic tourism is another area with unexplored growth potential and the increasing number of hotel and leisure facilities should invert the current flow from the capital to the regions.

Table 4: Current and potential types of tourism in Georgia

Existing markets for further development

Tourism type	Destination hubs	High Season	Perspective Locations
Cultural tourism, including food and wine	Kakheti (Telavi, Sighnagi and Kvareli), Svaneti, Tusheti, Mtskheta	Spring-Fall	Vardzia, Uplistsikhe, David Gareji, Khada Gorge, Zugdidi, Kutaisi
Ecotourism, including mountain travel, skiing and adventure travel	Gudauri, Bakuriani, Kazbegi, Mestia, Kakheti	Spring-Fall	Bakhmaro, Goderdzi Pass, Mt. Ushba, Lagodekhi, Vashlovani, Mtirala and Kolkheti national park
Sea tourism	Black Sea coast (Batumi, Kobuleti, Kvariati, Gonio, Mtsvane Kontskhi, Ureki)	July-September	Anaklia
Business travel, including MICE	Tbilisi, Batumi, Kobuleti, Bazaleti complex	Year-round	Kutaisi, Telavi
Visits to Friends and Relatives	Throughout the country	Year-round	Throughout the country
Casinos/Gaming	Tbilisi, Batumi	Year-round	Borjomi, Tskaltubo, Anaklia

Under-developed market segments

Tourism type	Destination hubs	High Season	Perspective Locations
Special events, including fairs, sports and music	Tbilisi, Batumi, Sighnagi, Telavi	Spring-Fall	Chargali, Kakheti, Maltakva, Anaklia, Kutaisi, Rustavi, Gori
Spa and wellness	Tbilisi, Sairme, Nunisi, Tskaltubo	Spring-Fall	Tskaltubo, Akhtala, Borjomi, Likani, Tbilisi, Utsera, Surami, Bakhmaro, Beshumi

Source: "Tourism Development and Investment Plan and Strategy – Task 7 Report" by the America-Georgia Business Council and SW Associates, BoG Research

Case Study: Hotel Sector

Growth and development makes investment into Georgia's tourism industry attractive and accommodation is a priority, in our view. The sector follows a life cycle of development, consolidation, stagnation and decline. Based on arrival numbers and qualitative data, Georgia is entering the development stage. International examples suggest this stage – all else being equal – should last at least 10 years. We believe the accommodation segment, marked by a shortage of hotel rooms, is particularly attractive for investment.

There is a shortage of accommodation supply. Based on a ratio of the average number of beds per 1,000 arrivals/population in Georgia and peer countries, room capacity in Georgia is some 3.1-5.2x smaller than in peer countries, while the bed penetration level is 4.1-6.5x lower. This, in our view, will leave a shortfall of accommodation facilities once visitor numbers grow in-line with projections.

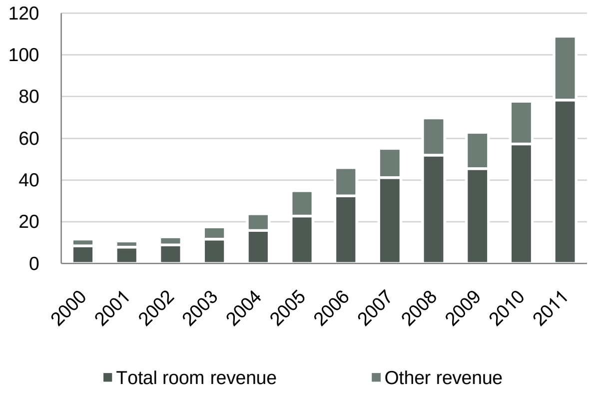
Table 5: Accommodation penetration ratios, 2010

	Penetration (per 1000 arrivals)			Penetration (per 1000 population)		
	Accom. Units	Rooms	Beds*	Accom. Units	Rooms	Beds*
Croatia	0.2	13.9	na	0.5	28.7	na
Montenegro	0.3	na	na	0.5	na	na
Cyprus	0.4	na	40.6	0.8	na	80.0
Spain	0.3	na	33.0	0.4	na	37.8
Iceland	0.3	8.1	17.2	1.1	31.0	65.6
Slovenia	0.5	22.1	59.9	0.5	20.2	54.7
Estonia	0.5	10.3	24.3	0.9	16.2	38.4
Latvia	0.5	11.6	26.0	0.3	7.1	16.0
Czech Republic	0.9	22.1	56.4	0.7	17.2	43.9
Poland	0.6	9.9	48.6	0.2	3.2	15.9
Lithuania	0.6	14.4	34.3	0.3	6.6	15.7
Romania	0.7	16.0	37.1	0.2	5.6	13.1
Average	0.5	14.3	37.7	0.5	15.1	38.1
Georgia**	0.2	4.6	9.2	0.1	2.9	5.9
Average vs. Georgia		3.1x	4.1x		5.2x	6.5x

**A bed is defined as a single sleeping place for a person; a queen bed is considered as two beds*
***Georgian data is as of 2011*
Source: WB, Statistics Departments of respective countries, BoG Research

There is a strong revenue growth in accommodation. Between 2000 and 2011, total revenues of accommodation units increased 9.4x to US$ 109mn (GEL 183.7mn) and room revenue increased 9.3x to US$ 78mn (GEL 132mn). 'Other revenue' which is mainly represented by food and beverage increased significantly (up 49% y/y to US$ 30.6mn) accounting for 28% of total hotel revenue in 2011.

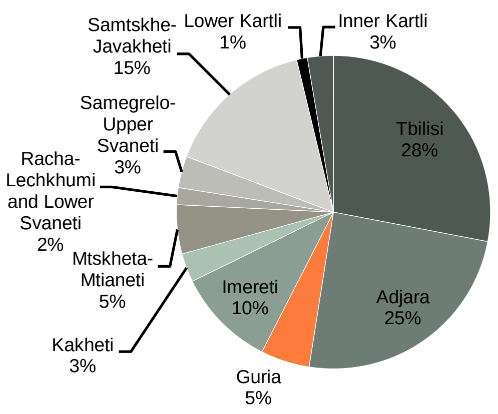
Figure 15: Revenue of accommodation units in Georgia, US$ mn



Source: GeoStat

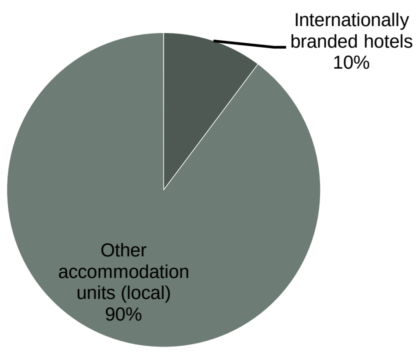
The room stock of accommodation units is concentrated in Tbilisi and Adjara. The capital boasts the largest number of branded hotel rooms, but local unbranded hotels dominate the broader lodging market in Georgia. As of end-2011, the country had over 600 registered accommodation units (all organizations registered as having accommodation services), with around 12,900 rooms and over 25,800 beds. Naturally, Tbilisi and Adjara hold the majority of room stock.

Figure 16: Distribution of rooms by regions, 2011



Source: GeoStat

Figure 17: Distribution of rooms in Georgia by accommodation type, 2011



Source: GeoStat, BoG Research

Tbilisi accounts for the highest share of revenue from available rooms. With almost equal number of rooms available in Tbilisi and Adjara, Tbilisi accounted for 56% (US$ 44.1mn) of total room revenue in Georgia in 2011 while Adjara accounted for only 21% (US$ 16.5mn). Tbilisi has 6 internationally branded hotels while there are only 2 in Adjara (both located in Batumi), with more branded hotels in the pipeline in both of these destinations. The majority of room stock in Adjara is concentrated in Batumi. Adjara is still a seasonal destination, although other entertainment options have become available to allow all-year tourism.

Tbilisi currently attracts the largest share of international arrivals (42%), followed by Batumi (39%), largely due to business, leisure and gaming tourism. Currently, 27% of international arrivals stay in hotels, mainly on business and leisure, with the rest staying at private facilities or not spending a night in Georgia.

With sufficient investment, Batumi and Tbilisi hold strong potential for MICE tourism, a fairly new form of business tourism, and to position themselves as hubs for conferences, conventions, and exhibitions. According to the survey conducted by ACT, only 4% of international arrivals and 1% of domestic arrivals attended any type of events, presentations or conferences in 2011.

Leisure and recreation tourism is poised to gain the largest share in the future, according to our projections. Global statistics show that leisure and recreation travelers are drawn mostly to branded mid-scale and branded budget hotels, while business travelers tend to stay in branded mid- and up-scale hotels. We thus believe branded mid-scale and branded budget hotels should be a priority in Tbilisi and Adjara.

Tbilisi, the key investment destination

International brands are establishing roots in Tbilisi. Five international hotel brands and one budget apart-hotel are currently present in the capital, accounting for 26% (952 units) of the city's room stock. The city enjoys year-round tourism. Tbilisi serves as the country's business hub and accounts for a significant chunk of Georgia's foreign investment.

Table 6: International hotel brands in Tbilisi

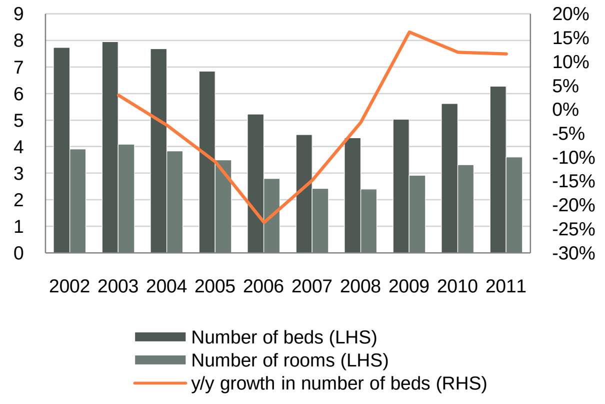
Name	Management	Stars	No. of Rooms	Opening Year
Holiday Inn	Intercontinental Hotels Group	4	252	2010
Radisson Blu Iveria Hotel	Rezidor Hotel Group	5	249	2009
Sheraton Metechi Palace Hotel	Starwood Hotels & Resorts	5	140	1990
Tbilisi Marriott	Marriott International	5	127	2002
Courtyard by Marriott	Marriott International	4	118	2003
Citadines	Ascott Ltd.	3	66	2009
Total			952	

Source: Respective hotels

Hilton Worldwide Inc. (110 rooms), Golden Tulip (103 rooms), Novotel (160 rooms), and Park Inn (100 rooms) plan to start operations in Tbilisi between 2013 and 2015.

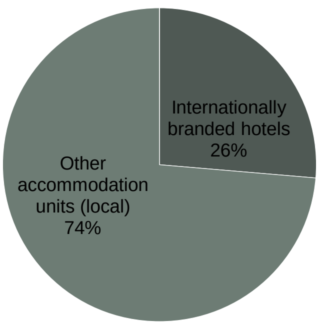
Aside from the international names, the overall number of rooms and beds in Tbilisi has grown slowly since 2008. As of 2011, Tbilisi hosts over 150 accommodation units, around 3,600 rooms and up to 6,300 beds. The majority of the hotels in Tbilisi offer meeting rooms or event halls to accommodate business travelers.

Figure 18: Number of rooms and beds in Tbilisi, '000



Source: GeoStat

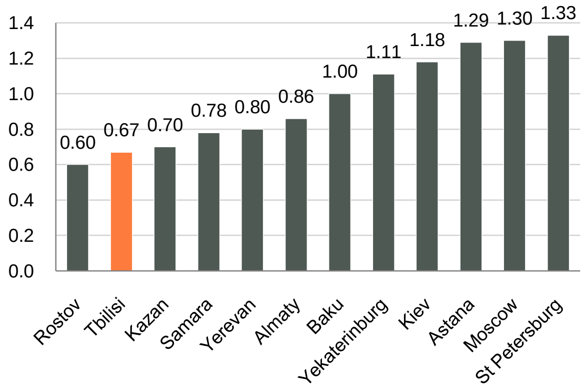
Figure 19: Distribution of rooms in Tbilisi by accommodation type, 2011



Source:GeoStat, BoG Research

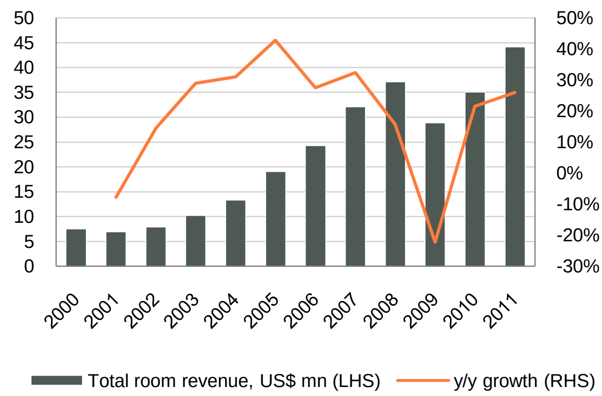
The room penetration ratio in Tbilisi stands at 0.67, which is 33% lower than the average of the other selected cities. Total revenue from rooms available in Tbilisi has been on the rise since 2009, reaching US$ 44.1mn (56% of total room revenue in Georgia) in 2011.

Figure 20: Rooms per 1000 population



Note: Includes rooms of only international branded hotels and local equivalents
Source: HVS Global Hospitality Services

Figure 21: Total room revenue in Tbilisi



Source: GeoStat

Branded mid-scale hotels with conference facilities and branded budget hotels are an appropriate target for business (including MICE), leisure and gaming tourism. We believe Tbilisi's brand hotel market will be shaped mainly by business travelers (including MICE), that usually prefer brand hotels for their uniformity and conference facilities. As business travelers are usually higher-yielding, they require a level of services that may not provided by local budget facilities. Business visitors tend to choose brand hotels as they expect a predictable standard of services. Leisure travelers also generally prefer brand hotels, namely branded mid-scale and branded budget hotels.

Adjara

Adjara is located in southwest Georgia on the Black Sea north of Turkey and has a population of 370,000 (8%). Batumi is the region's administrative center and Kobuleti is a seaside resort town, where the government established the country's first Free Tourism Zone (FTZ). The coastal area has good infrastructure, including roadways, rail lines connected to the country's main transport network and an international airport. Batumi also plays host to a critically acclaimed annual Jazz festival.

International brands began entering Batumi over the past few years. Two international branded hotels operate in Batumi, representing 12% (370 units) of the total rooms in Adjara. Other local 5-star hotels in Batumi include Hotel Intourist Palace (145 rooms) and President Plaza (35 rooms). Kobuleti has one 5-star hotel, the Georgia Palace Hotel (156 rooms).

Table 7: International hotel brands in Batumi

Name	Management	Stars	No. of rooms	Opening year
Sheraton Batumi Hotel	Starwood Hotels & Resorts	5	202	2010
Radisson Blu Hotel	Rezidor Hotel Group	5	168	2011
Total			370	

Source: Respective hotels

Another several branded hotels are in the pipeline for the Batumi market by 2015. All of these 5-star hotels are to have conference halls and in some cases casinos.

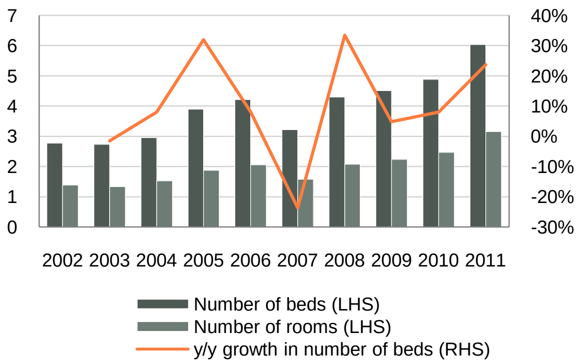
Table 8: Pipeline of International hotel brands in Batumi

Name	No. of rooms	Opening year
Kempinski	344	2015
Marriott	300	N/A
Hilton	248	2015
Princess Hotel	200	2013
Holiday Inn	180	2013
Envil Batumi	150 +	2015
Porto Fini	150 +	2016
Semiramida Gardens	110	2013
Total	1682 +	

Source: The Ministry of Finance and Economy of Adjara

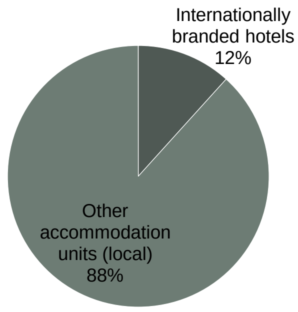
Alongside those brands, the overall number of rooms and beds in Adjara has grown steadily since 2007. As of 2011, Adjara had over 150 accommodation facilities, up to 3,200 rooms, and over 6,000 beds.

Figure 22: Number of rooms and beds in Adjara, '000



Source: GeoStat

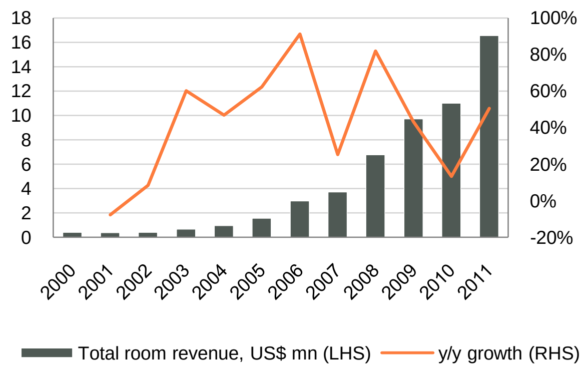
Figure 23: Distribution of rooms in Adjara by accommodation type, 2011



Source: GeoStat, BoG Research

Total revenue from rooms available in Adjara has been growing since 2002, reaching US$ 16.5mn (21% of total room revenue in Georgia) in 2011.

Figure 24: Total room revenue in Adjara



Source: GeoStat

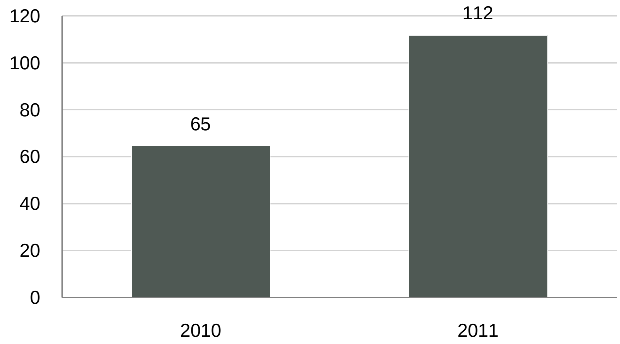
Gaming is another key attraction. Georgia legalized gaming in 1992, whereas neighbors banned or tightly controlled gaming throughout the 1990s. With gaming prohibited in Russia, Ukraine, Kazakhstan, Turkey and Israel, Georgia has the added attraction of being a regional gaming hub. Over 400mn people live within a few hours' flight.

Map 1: Gaming Industry – Regional Hub

Source: MESD, BoG Research

There are currently 8 casinos in Georgia, most located in Batumi. The number of casino visitors in Batumi rose 73% y/y in 2011.

Figure 25: Number of casino visitors in Batumi, '000



Source: *MESD*

Legal Environment in Brief

The GNTA, under the authority of the MESD, is responsible for policymaking in the tourism sector. The GNIA, also under the authority of the MESD, serves as a liaison between foreign investors and the government.

Special permits and licenses are not required to develop hotels in Georgia, but construction permits are required. According to the World's Bank's *Doing Business* survey, the process of receiving a construction permit has been simplified to just 9 procedures taking on average no more than 74 days.

Registering a company is fast, simple, and inexpensive. Registration is carried out by the NAPR and can be completed in one day.

Foreigners do not require special work permits. Nationals of over 80 countries can enter Georgia for 360 days without a visa. In cases where required, one-year visas are issued at border points.

The tax code, passed in 2005, simplified the tax framework and reduced tax rates. Georgia has signed bilateral treaties on investment protection with 32 countries and bilateral double taxation treaties with 30 countries. The government also offers a number of tax benefits:

- No social insurance tax
- CapEx can be depreciated fully in the year incurred, with an available 5-year loss carry forward
- No capital gains tax
- No wealth tax, inheritance tax or stamp duty
- Foreign-sourced income for individuals is fully exempted

Table 9: Taxes in Georgia

	2012
VAT	18%
Income Tax	20%*
Corporate Profit Tax	15%
Dividend & Interest Income Tax	5%
Property Tax	up to 1%

**The income tax is a flat 20%*
Source: MoF

FTZs were established in the coastal cities of Kobuleti (Adjara) and Anaklia (Samegrelo). The regions offer (for free) the following terms to investors:

- Land
- Hotel design projects
- Full engineering utility networks and corresponding outdoor infrastructure (water, electricity, gas lines, and new roads)
- Corporate profit tax exemption for 15 years
- Property tax exemption for 15 years

Anaklia also offers casino license for hotel capacity over 80 rooms and Georgian citizenship for foreign investors.

Tourism Sector SWOT

Strengths

- Liberalized economy
- Investor-friendly legal and tax framework
- Low corruption rate
- One of the lowest crime rates in Europe
- Ease of starting business
- Positive attitude of population to international visitors
- High number of world heritage cultural and natural sites

Weakness

- Further need of improvement in tourism infrastructure
- Lack of sufficient budget airline access
- Insufficient flight frequencies and destinations
- Shortage of trained hospitality staff
- Weak understanding of international quality requirements in tourism services
- Low competition, high prices for hotels and airlines

Opportunities

- Shortage of hotels especially in Tbilisi and Adjara. Arrivals growth rate outpacing growth of lodging facilities
- FTZs (offering tax breaks or exemptions)
- Key tourist destinations still under development
- Tourism industry in development stage, potential to gain market share faster due to early entry

Threats

- Geopolitical situation
- Unfavorable economic environment in countries where most of Georgia's visitors originate
- Unfavorable changes in the image of the country

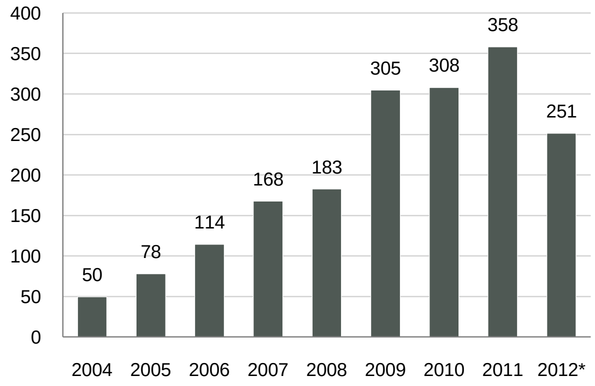
Appendices

Appendix 1: Infrastructure

Roads are currently the key mode of entry. Shared borders with Armenia, Azerbaijan, Turkey and Russia make road access from these destinations relatively easy. The majority of arrivals from neighbors enter Georgia by road.

Substantial domestic and foreign investments have been made in recent years into the sector – over US$ 1.8bn during 2004-2012. As of 2011, 31% of secondary road infrastructure (5,488km) is in good condition while 84% of total international roads (1,455km) is in good condition without the need for major works. The main routes to all key tourist destinations in Georgia are in good condition, much better than in most peer countries.

Figure 26: Road infrastructure investments (state and donors), US$ mn



**Preliminary data*

Source: MRDI

Growth in arrivals from non-neighbor territories will put emphasis on airport infrastructure. Georgia currently boasts four airports: three international/domestic in Tbilisi, Batumi and Kutaisi, as well as a domestic point in Mestia. Kutaisi International Airport officially opened in September 2012, with Hungarian low-cost carrier Wizz Air launching direct flights from Kutaisi to Kyiv. Kutaisi International Airport has the largest annual capacity of 4.4mn passengers.

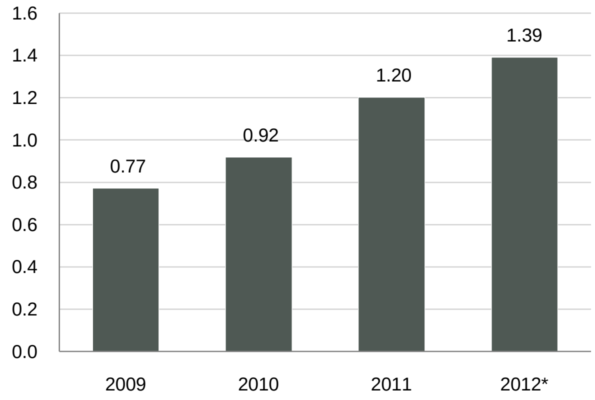
Table 10: Overview of Georgian airports

	Number of airlines	Operator	Annual passenger transport capacity
Tbilisi International Airport	27	TAV	2.8mn
Batumi International Airport	5	TAV	0.6mn
Kutaisi International Airport	1	State Operator	4.4mn
Mestia Queen Tamar Airport	1	State Operator	0.3mn

Source: MESD

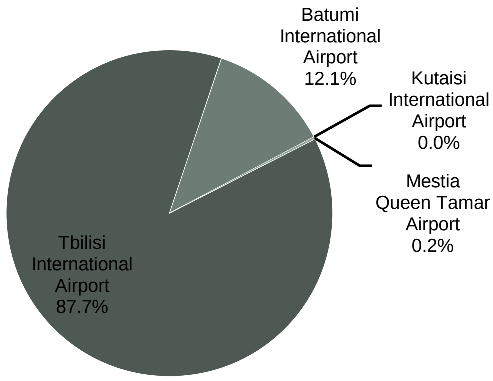
Air travel has risen alongside the increase in arrival numbers. In 2012, the number of air passengers increased 16% y/y to 1.4mn. Tbilisi accounted for 88% of that total and Batumi accounted for 12%.

Figure 27: Airport passenger throughput in Georgia, mn



*Preliminary data
Source: GCAA

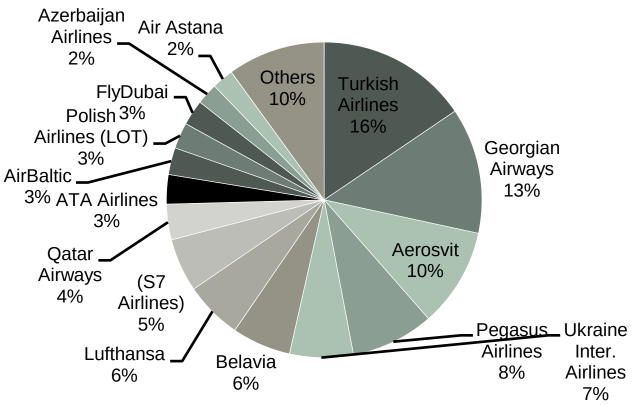
Figure 28: Breakdown of passengers by airport in Georgia, 2012*



*Preliminary data
Source: GCAA

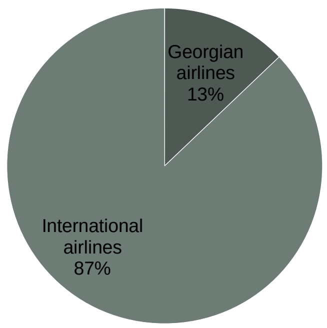
In 2012, the Tbilisi airport hosted 27 airlines including several new airlines (Ata Airline, Air Astana, China Southern, Ural Airlines and Fly Dubai). International airlines dominate the market.

Figure 29: Airline market share, Tbilisi Airport, 2012*



*Preliminary data
Source: GCAA

Figure 30: Share of domestic and international airlines, Tbilisi Airport, 2012*



*Preliminary data
Source: GCAA

Railways will likely become an important mode of transport for travelers. The national rail company transported 3.3mn passengers in 2011 (and 2.4mn in 9M12), a number that has been largely stable over the last several years. Georgian Railway is currently undertaking a significant modernization, after which passengers will be able to travel from Tbilisi to the Black Sea in just three hours vs. the current 7-8 hours. Moreover, the new Baku-Tbilisi-Kars line will open a new transportation corridor from the Caspian Sea through Turkey to Europe, via the rail tunnel under the Bosporus Strait.

Map 2: Regional Gateway

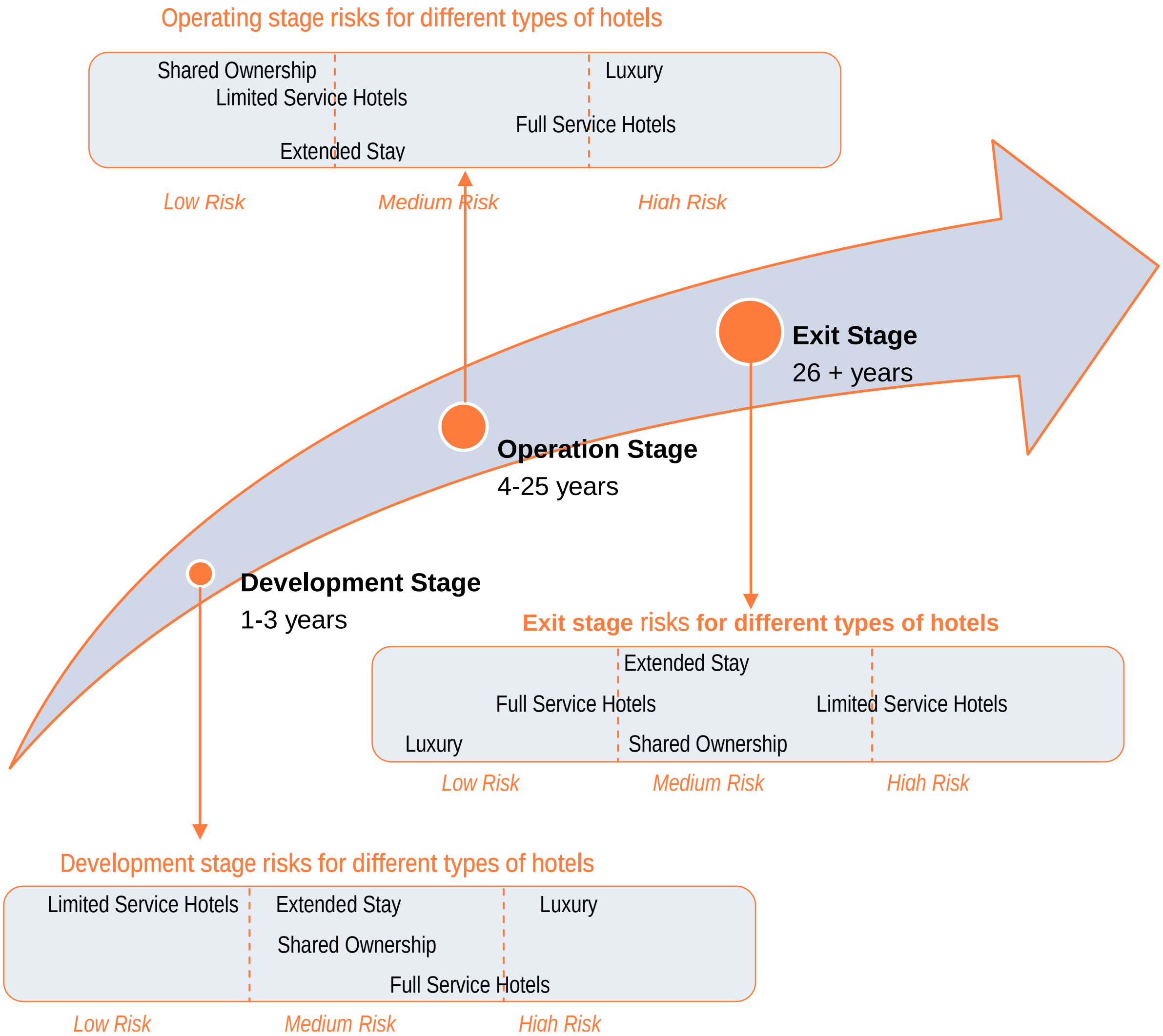
Source: MESD, BoG Research

Appendix 2: Hotel Life Cycle

For an investor, the life cycle of a hotel can be divided into three stages: development, operation, and exit. Development takes about 1-3 years and a typical investor operates it for 4-25 years. At the end of the life cycle, the investor either sells the property or renews it.

The risks inherent in all three stages are:

- **Development risk:** The investor will not be able to construct the asset and make it fully operational. Luxury and full-service hotels have higher development risks as they take more time to develop, are highly capital intensive and face high expectations.
- **Operating risk:** The asset will not generate sufficient cash flow to make the investment economically viable. The total return consists of cash flow earned during the holding period and capital appreciation/depreciation. Luxury and full-service hotels bear higher operating risks.
- **Exit risk:** The ability of an investor to exit the project or extend its economic life. Luxury and full-service hotels have lower exit risk.



Source: Extract from "Hotel Investment Risk: What Are The Chances?", 2006 by HVS Global Hospitality, BoG Research

Appendix 3: Classification of Hotel Properties

Table 11: Classification of hotel properties

Classification	Typical characteristics/features	Sample international brands
Budget/Economy	Net room size: 12-18 sqm Staff/room ratio: ca. 0.1-0.2/room Limited food and beverage facilities No amenities	Etap, Ibis, Express by Holiday Inn, easy hotels
Mid-scale	Net room size: 20-24 sqm Staff/room ratio: ca. 0.4 – 0.5/room Limited food and beverage facilities Limited amenities (e.g. meeting space, gym)	Mercure, Holiday Inn, Courtyard by Marriott, Campanile
Up-scale	Net room size: 24-35 sqm Staff/room ratio: ca. 0.6 – 0.8/room Extensive food and beverage facilities Extensive amenities (e.g. meeting space, retail outlets, wellness centre)	Radisson, Sofitel, Hilton, Intercontinental, Marriott

Source: "Real Estate, Leisure & Tourism Practice CEE: Hotel Development Costs 2009: Guidelines for new hotel projects in Central and Eastern Europe" by KPMG

Appendix 4: Models

Hypothetical branded mid-scale hotel (with restaurant)

Assumptions

Loan to Equity ratio	60% / 40%	Cost of Debt	13.0%
Construction period	2 years	Cost of Equity	18.0%
Number of rooms	100	WACC	13.8%
Average room rate*, US$ (assumption for 2013)	130		
Capex, US$	15,000,000		

Income statement, US$ '000	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F
Annual occupancy	0	0	65%	68%	70%	73%	75%	75%	75%	75%	75%	75%
Average room rate, US$	0	0	141	146	152	158	164	171	178	185	192	200
Revenues, of which	0	0	4,937	5,383	5,790	6,236	6,709	6,997	7,257	7,547	7,849	8,185
Rooms	*0*	*0*	*3,336*	*3,613*	*3,886*	*4,186*	*4,503*	*4,696*	*4,870*	*5,065*	*5,268*	*5,494*
F&B	*0*	*0*	*1,334*	*1,445*	*1,554*	*1,674*	*1,801*	*1,878*	*1,948*	*2,026*	*2,107*	*2,197*
Other	*0*	*0*	*267*	*325*	*350*	*377*	*405*	*423*	*438*	*456*	*474*	*494*
y/y change, total revenues	na	na	na	9.0%	7.6%	7.7%	7.6%	4.3%	3.7%	4.0%	4.0%	4.3%
Departmental expenses	0	0	1,578	1,721	1,852	1,994	2,146	2,238	2,321	2,414	2,510	2,618
Departmental income	0	0	3,359	3,661	3,938	4,242	4,564	4,759	4,936	5,134	5,339	5,568
Gross Margin	na	na	68.0%	68.0%	68.0%	68.0%	68.0%	68.0%	68.0%	68.0%	68.0%	68.0%
Other operating expenses	0	0	1,049	1,103	1,164	1,229	1,305	1,350	1,390	1,442	1,499	1,563
Income before fixed charges	0	0	2,310	2,558	2,774	3,013	3,259	3,409	3,546	3,692	3,840	4,004
Operating Profit Margin	na	na	46.8%	47.5%	47.9%	48.3%	48.6%	48.7%	48.9%	48.9%	48.9%	48.9%
Fixed charges	0	0	444	484	521	561	604	630	653	679	706	737
Net Operating Income	0	0	1,866	2,073	2,253	2,452	2,655	2,779	2,893	3,013	3,133	3,268
Net Operating Profit Margin	na	na	37.8%	38.5%	38.9%	39.3%	39.6%	39.7%	39.9%	39.9%	39.9%	39.9%

*Net of VAT

Hypothetical branded mid-scale hotel (with restaurant)

Valuation, US$ '000	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F
Fully taxed NOI	0	0	1,676	1,854	2,008	2,178	2,351	2,458	2,557	2,660	2,764	2,880
Capital expenditures	-6,000	-9,000	-173	-188	-203	-218	-235	-245	-254	-264	-275	-286
VAT (returned on CapEx)	0	1,098	1,646	0	0	0	0	0	0	0	0	0
Unlevered FCF	-6,000	-7,902	3,149	1,665	1,805	1,959	2,117	2,214	2,303	2,396	2,489	2,593
WACC	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%
Discount factor	0.90	0.79	0.69	0.61	0.53	0.47	0.41	0.36	0.32	0.28	0.25	0.22
Present value of FCF	-5,380	-6,225	2,179	1,012	964	919	872	802	733	670	611	559
Cumulative present value of FCF	-2,283											
Capitalization rate	11.0%											
Terminal value	26,180											
Transaction costs (2%)	524											
Present value of TV (incl. TC)	5,533											
NPV	3,250											
IRR	18.1%											

NPV Sensitivity analysis, US$ '000

		Average room rate, US$*				
		124	127	130	133	136
Capitalization rate	10.0%	3,167	3,485	3,803	4,122	4,440
	10.5%	2,890	3,202	3,514	3,826	4,138
	11.0%	2,638	2,944	3,250	3,556	3,862
	11.5%	2,408	2,709	3,010	3,310	3,611
	12.0%	2,198	2,493	2,789	3,085	3,380

NPV Sensitivity analysis, US$ '000

		Average room rate, US$*				
		124	127	130	133	136
WACC	12.8%	3,592	3,923	4,254	4,585	4,916
	13.3%	3,102	3,420	3,739	4,057	4,375
	13.8%	2,638	2,944	3,250	3,556	3,862
	14.3%	2,198	2,493	2,787	3,081	3,376
	14.8%	1,781	2,064	2,348	2,631	2,915

*Net of VAT

Hypothetical unbranded mid-scale hotel (with restaurant)

Assumptions

Loan to Equity ratio	60% / 40%	Cost of Debt	13.0%
Construction period	2 years	Cost of Equity	18.0%
Number of rooms	100	WACC	13.8%
Average room rate*, US$ (assumption for 2013)	110		
Capex, US$	12,000,000		

Income statement, US$ '000	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F
Annual occupancy	0	0	55%	58%	60%	63%	65%	65%	65%	65%	65%	65%
Average room rate, US$	0	0	119	124	129	134	139	145	151	157	163	169
Revenues, of which	0	0	3,463	3,776	4,086	4,427	4,788	4,993	5,179	5,386	5,601	5,841
Rooms	*0*	*0*	*2,388*	*2,604*	*2,818*	*3,053*	*3,302*	*3,444*	*3,572*	*3,714*	*3,863*	*4,029*
F&B	*0*	*0*	*955*	*1,042*	*1,127*	*1,221*	*1,321*	*1,377*	*1,429*	*1,486*	*1,545*	*1,611*
Other	*0*	*0*	*119*	*130*	*141*	*153*	*165*	*172*	*179*	*186*	*193*	*201*
y/y change, total revenues	na	na	na	9.0%	8.2%	8.3%	8.2%	4.3%	3.7%	4.0%	4.0%	4.3%
Departmental expenses	0	0	1,099	1,198	1,296	1,404	1,519	1,584	1,643	1,709	1,777	1,853
Departmental income	0	0	2,365	2,578	2,790	3,023	3,269	3,409	3,536	3,677	3,824	3,988
Gross Margin	na	na	68.3%	68.3%	68.3%	68.3%	68.3%	68.3%	68.3%	68.3%	68.3%	68.3%
Other operating expenses	0	0	823	868	915	974	1,041	1,079	1,111	1,147	1,196	1,250
Income before fixed charges	0	0	1,542	1,710	1,875	2,049	2,228	2,331	2,425	2,530	2,629	2,738
Operating Profit Margin	na	na	44.5%	45.3%	45.9%	46.3%	46.5%	46.7%	46.8%	47.0%	46.9%	46.9%
Fixed charges	0	0	260	283	306	332	359	374	388	404	420	438
Net Operating Income	0	0	1,282	1,426	1,568	1,717	1,869	1,956	2,037	2,126	2,208	2,300
Net Operating Profit Margin	na	na	37.0%	37.8%	38.4%	38.8%	39.0%	39.2%	39.3%	39.5%	39.4%	39.4%

*Net of VAT

Hypothetical unbranded mid-scale hotel (with restaurant)

Valuation, US$ '000	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F
Fully taxed NOI	0	0	1,162	1,285	1,406	1,533	1,664	1,739	1,808	1,886	1,957	2,036
Capital expenditures	-4,800	-7,200	-121	-132	-143	-155	-168	-175	-181	-189	-196	-204
VAT (returned on CapEx)	0	878	1,317	0	0	0	0	0	0	0	0	0
Unlevered FCF	-4,800	-6,322	2,358	1,153	1,263	1,379	1,496	1,564	1,627	1,697	1,761	1,831
WACC	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%	13.8%
Discount factor	0.90	0.79	0.69	0.61	0.53	0.47	0.41	0.36	0.32	0.28	0.25	0.22
Present value of FCF	-4,304	-4,980	1,632	701	675	647	617	566	518	474	432	395
Cumulative present value of FCF	-2,627											
Capitalization rate	11.0%											
Terminal value	18,508											
Transaction costs (2%)	370											
Present value of TV (incl. TC)	3,912											
NPV	1,284											
IRR	16.0%											

NPV Sensitivity analysis, US$ '000

Capitalization rate	Average room rate, US$*: 104	107	110	113	116
10.0%	1,148	1,412	1,676	1,939	2,203
10.5%	954	1,213	1,471	1,729	1,987
11.0%	778	1,031	1,284	1,538	1,791
11.5%	617	866	1,114	1,363	1,612
12.0%	469	714	958	1,203	1,448

NPV Sensitivity analysis, US$ '000

WACC	Average room rate, US$*: 104	107	110	113	116
12.8%	1,434	1,708	1,982	2,256	2,530
13.3%	1,097	1,360	1,624	1,887	2,150
13.8%	778	1,031	1,284	1,538	1,791
14.3%	476	719	963	1,206	1,450
14.8%	189	424	658	893	1,127

*Net of VAT

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