



Horwath HTL

Hotel, Tourism and Leisure

MARKET REPORT

Mexico *Market Update*

OCTOBER 2020 (updated)

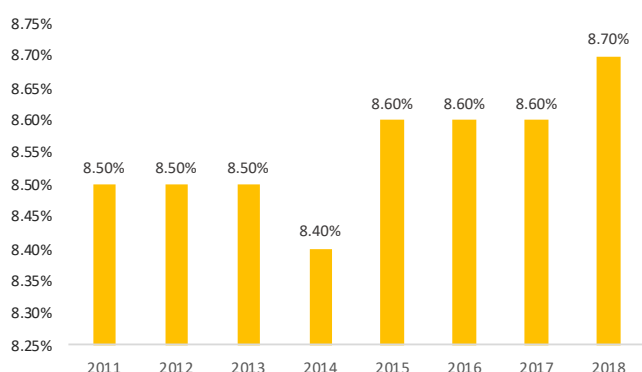
Mexican Tourist Outlook 2020

The following analysis will examine the current state of the Mexican economy, the tourism sector, and the evolution of variables that have a tangible influence on the hotel industry in Mexico.

Size of the Mexican Hotel Industry

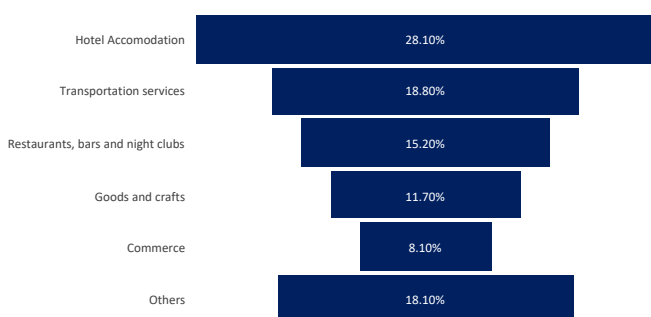
There should be no doubt about the economic importance of tourism for Mexico. In 2019, 44.7 million foreign tourists visited Mexico and the total income for this concept amounted to 24.6 billion dollars. In that same year, Mexico was ranked number 7 worldwide for the number of international tourists (OMT). The sector directly accounts for an 8.7% share of the Mexican GDP and provides employment for 2.3 million people (2018). Tourism provides 6% of the total amount of work in the economy and is in first place as a youth-employer sector, as well as in second place for women-employer sector.

Tourism's share in national GDP 2011-2018



Source: INEGI, 2018

Composition of tourism's GDP in Mexico



Source: INEGI, 2018

With more than 11,100 km of coastline and landscape that varies from desert to mountains and rainforests, as well as an abundant cultural heritage that includes well-preserved ancient indigenous cities, Mexico has a privileged geographical location that appeals to its North American neighbors.

Number of Rooms

Country	Number of Rooms	%
Mexico	808,139	36%
Brazil	541,314	24%
Colombia	307,458	14%
Perú	304,640	13%
Argentina	118,858	5%
Ecuador	74,173	3%
Costa Rica	57,233	3%
Chile	45,112	2%

Source: DATATUR, MINCETUR, REPORTUR, SERNATUR, EMBRATUR

Mexico occupies the biggest share in number of rooms, 808,139, when compared to Central and South American countries. It is followed by Brazil with 541,341 rooms and Colombia with 307,458.

In 2019 Mexico was located in second place for biggest growth in supply when compared to the North American region.

Global Supply	Dec 2019 vs 2018
Canada	1.50%
United States	2.00%
Mexico	2.40%
Caribbean	2.80%
Central America	1.10%
South America	1.30%
Europe	1.40%
Middle East	5.90%

Source: STR, February 2020

Mexico's Top 10 Markets for New Rooms Before Covid

Cancun	4,750
Riviera Maya	2,458
CDMX	1,814
Monterrey	1,645
Los Cabos	840
Puerto Vallarta	792
Guadalajara	612
Mexicalli	276
Cd. Juarez	140
Chihuahua	126

Source: STR, February 2020

Cancun is the main and fastest-growing market for new rooms (35%), followed by Riviera Maya (18%) and Mexico City (14%).

Mexico has several destinations that highlight its history and Pueblos Magicos (Magic Towns) that have not been marketed to their full potential. There is an opportunity to develop boutique hotels in places that are neither cities, beaches nor industrial areas, but colonial cities. Though these are not very large hotels, they have proven to be a very profitable business in European destinations.

Though the country is not among the top countries in tourism-income generation, the country does receive a significant number of visitors. Mexico is in the 37th position worldwide in terms of average spending per tourist with \$ 496 per capita in 2019. A challenge presented for the sector is to get tourists to spend more money in the country.

During 2019 Mexico experienced a pronounced decrease in RevPAR as well as a decrease in ADR. A fall in RevPAR is both occupancy-driven and ADR-driven. Room Supply increased 3.10% while Room Demand fell -0.5%. The following chart illustrates the main trends during the year 2019.

Mexico 2019 Year End Growth

Room Supply	3.10%
Room Demand	-0.50%
Occupancy	-2.60%
ADR	-2.50%
RevPAR	-5.00%

Source: STR, February 2020

We consider that this drop is mainly due to three factors: a) Changes in the budget dedicated to tourism promotion and the dissolution of the Mexican Tourism Promotion Council b) natural phenomenon such as sargassum, and c) an increase in the perception of insecurity throughout 2019 which had as a consequence the issuance of a travel warning by the United States -the main market for international tourists- to 16 states of Mexico.¹

Cruise Industry

The outlook for the cruise industry during 2020 was positive. This segment had a growth rate of 8% as of 2019, which is considered accelerated compared to the rest of the tourism sector whose rate was 6%.

The Center for Disease Control has issued boating ban orders until September 30. On the other hand, the International Association of Cruise Lines voluntarily ended operations until October 31. According to official data, in Mexico during the period January-June 2020 almost 3 and a half million cruise passengers have been lost. The greatest impacts have been presented in the Caribbean, particularly in the ports of Cancún and Majahual in Quintana Roo, while in the Pacific the hardest-hit ports have been Ensenada in Baja California, Puerto Vallarta, Jalisco, and Mazatlán, Sinaloa.

	Jan 2020	June 2020	Var %
Ports in Pacific	1,197,311	589,114	-50.80%
Ports in Gulf Caribbean	3,475,801	1,703,996	-51%
Total	4,673,112	2,293,110	-50.90%

Source: SECTUR, August 2020

¹ Chihuahua, Coahuila, Durango, Jalisco, Estado de México, Morelos, Nayarit, Nuevo Leon, San Luis Potosí, Sonora, Zacatecas, Colima, Guerrero, Michoacán, Sinaloa and Tamaulipas.



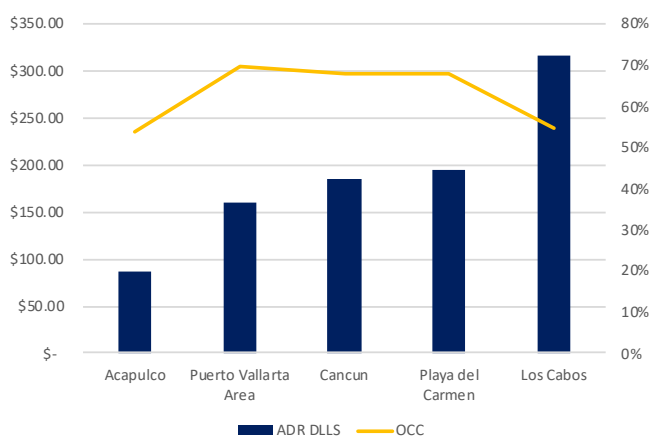
Mexico City

Key Performance Indicators

Resort Destinations

Los Cabos has the highest ADR of the beach destinations in Mexico, \$315. Playa del Carmen and Cancun follow, with ADRs of \$195.70 and \$185.70. Occupation wise, the Puerto Vallarta area, Cancun and Playa del Carmen present the most elevated occupancy rates with 69.6%, 67.9%, and 67.8% respectively.

Mexico's Top Beach Destinations Year-End KPI'S



Source: STR, February 2020

Mexico's Top Beach Destinations Year-End KPI'S	ADR DLLS	OCC
Acapulco	\$86.57	54%
Puerto Vallarta	\$160.52	70%
Cancun	\$185.70	68%
Playa del Carmen	\$195.70	68%
Los Cabos	\$315.80	55%

*Exchange Rate 31/12/2019: 1 DLR = 18.7018 MXN

Source: STR, February 2020



Urban Destinations

Mexico City has the highest ADR of the top city destinations in Mexico, \$120.31. The Mexico City Urban Area and Guadalajara Area follow, with ADRs of \$90.63 and \$80.69. Occupation wise, Tijuana, Mexico City, and the Monterrey Area present the most elevated occupancy rates with 66.8%, 65.8%, and 65.3% respectively.

Mexico's Top City Destinations Year-End KPI'S	ADR DLLS	OCC
Mexico City	\$120.31	66%
Guadalajara	\$80.69	62%
Monterrey	\$78.01	65%
Tijuana	\$75.82	67%
San Luis Potosi	\$71.81	57%
Merida	\$70.15	63.20%
Saltillo	\$68.71	54.60%
Queretaro	\$67.48	64.60%
Aguascalientes	\$66.84	54.10%
Puebla	\$62.99	47.70%
Leon	\$60.85	52.20%
Villahermosa	\$51.55	60%

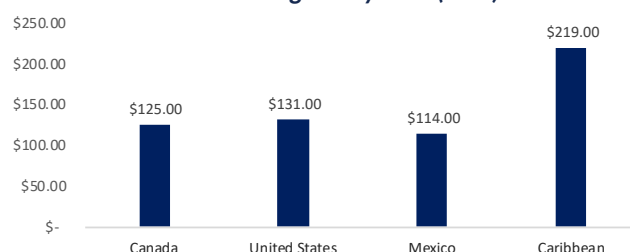
*Exchange Rate 31/12/2019: 1 DLR = 18.7018 MXN

Source: STR, February 2020

North America Comparison

The Caribbean area has the highest ADR of the North American region, \$219. The United States has an ADR of \$131 followed by Canada, \$125, and Mexico, \$114.

North America KPI'S: Average Daily Rate (USD)



Source: STR, February 2020

Mexico 2019 Year-End Growth	% Change	Avg Level
Occupancy	-2.60%	61%
ADR	-2.50%	\$120.90
RevPAR	-5.00%	\$76.04

Source: STR, February 2020



COVID-19 and its impact on the Mexican Hotel Industry

Since the beginning of the year, the global economic and financial environment has become significantly more adverse due to the challenges associated with the COVID-19 pandemic. Such global economic crisis has been unprecedented; unlike previous crisis in the past decades, this economic scenario was originated by a health problem, not within the financial or economic sphere. COVID-19 has had an abrupt impact on every sector of the global economy.

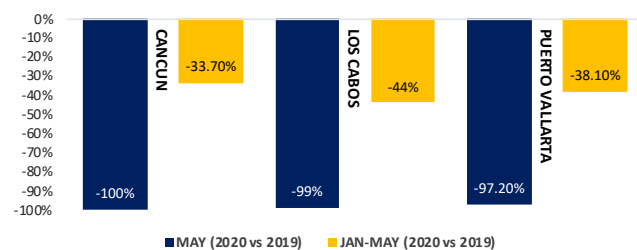
Worldwide measures of confinement and social distancing were implemented in order to contain the spread of the virus. This has had and will continue to have significant repercussions on financial markets, productive activity, and the inflationary process in the nation.

According to United Nations World Tourism Organization (UNWTO) the tourist flow could reduce from 58% up to 78% during 2020. No crisis that originated from a climatic, sanitary, nor financial or economic circumstance has had an analogous repercussion in the industry.

While, in other parts of the world, hotels had the option to close, tourism was declared a non-essential activity in Mexico. Therefore, hotel occupancy was restricted to 25%, directed only for guests performing any type of activity considered “essential”. It is estimated that the reopening

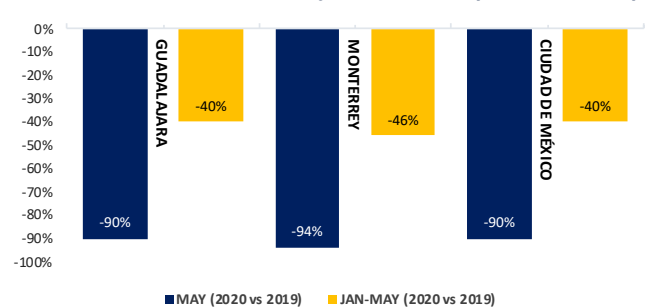
of hotels could take place during July or September. A large part of the recovery will come with the resumption of activities in the great metropolises, beginning with Mexico City. Until the date of preparation of this report, it has been considered that hotels within the city will be able to resume activities on July 1st under an occupation rate of 30% while keeping common areas closed to the public.

Annual Int. Arrivals in Cancun, Los Cabos and Puerto Vallarta



Source: GAP, ASUR

Annual Int. Arrivals in Guadalajara, Monterrey & Mexico City



Source: NAICM, OMA, GAP

Recovery for the Mexican Hotel Industry will be slow. When you combine the cancellation of events and overall travel with lower income related to job losses, it is a perfect storm for the sector. Though this is not the first time that the sector has faced a global crisis, we expect the recovery will take longer than after the 2009 crisis. We believe that the sector will not return to 2019 levels until the end of 2022.

Changes in currency rates affect the spending pattern of consumers in a destination. Mexico's travel and tourism performance relies largely on international arrivals from countries using the US dollar. Therefore, the behavior of Dollar-Mexican peso parity could result in a relevant competitiveness gain for the region

On one hand, outbound travel will become more economically accessible for Mexico's primary visitor markets such as the United States and Canada. Marketing campaigns and concentration in this audience is a way reach new potential travelers. On the other hand, inbound travel to countries where the US dollar prevails will become relatively more expensive for locals. Furthermore, the risk of traveling by plane for long periods of time could work as an incentive for traveling in national territory

Industries will have to take precautionary measures and change strategies for the possible emergence of another pandemic. Different health protocols from the World Health Organization, brands, and hotel associations will begin to emerge. Some hotels have opted to create a proper Sanitation Department with strict rules and protocols to keep guests safe. Hotel corporations are implementing technologies in their regular operation in order to limit face-to-face interactions while keeping high levels of service.

Guests will likely be able to make the check-in and check-out processes from their own devices and in some cases, they will even be able to make restaurant reservations, request airport transfers, order room service, among others. Digital menus and sustainable single-use packaging will be the new normal at restaurants and bars inside hotels, who will be required to have a socially distant set up and reduce their capacity levels. Public common areas will summon special cleaning procedures and sanitization in high-touch spots.

In some resorts, rooms will be implemented with new technologies to standardize the cleaning procedures. Due to the new protocols, hotels will have a higher cost than the average working capital.

Board members and management teams will have to find a balance point that defines under what conditions a hotel can remain open or remain closed and establish a protocol for each of these situations.

Without a doubt, the distribution of the vaccine will be the most effective antidote to encourage tourism in Mexico and in the world. In the months before the vaccine is distributed, the impulse will come from the lifting of travel restrictions and the decrease in the virus transmission levels. Much of the recovery of the tourism industry will come from the reactivation of the aeronautical sector and the government's return policies.

It is likely that individual demand will recover sooner than business or group demand. The younger, high-income generations, more than previous generations, are making travel a priority. Considering the COVID-19 pandemic, people will prefer destinations that are not mass marketed. On the short term, managers will have the challenge to offer a competitive rate without compromising the hotels' ability to cover its operational expenses.

We can expect that travelers' priorities include price and sanitary measures. In that sense, road tourism will be the first to recoup since travelers will feel more comfortable and safe travelling in their own vehicles. Therefore, it will be a challenge for the government to take prudent measures that guarantee the safety of all travelers while being on the road.

Hotels of economic, medium and upper-medium category that tend to be cheaper, have the potential to be the first to emerge from the economic impact of the pandemic since they have the ability to capture individual travelers and business travelers whose corporations are willing to move their employees for the realization of essential jobs.

The luxury category, due to its competitive advantages and, in some cases, the particular location of the resorts contributes to create a sense of loyalty in their clients. However, the luxury category will have to be very creative in attracting guests who are now facing an impending recession and will be price sensitive.

Large hotel corporations with an elevated number of rooms will present competitive challenges and opportunities. On the one hand, a difficult task for management teams will be the reduction of corporate expenses and working capital. On the other hand, by having larger spaces, resorts find it easier to design a common area for the exclusive use of guests while respecting social distancing measures.

On the **corporate side of the demand**, the market will recover gradually as the activities of each economic sector are resumed. We believe that there is going to be a relocation of manufacturing plants from Asia to Mexico after the COVID-19 pandemic has passed. This process is called reshoring² and nearshoring³. This will lead to strong demand for industrial warehouses in Mexico. Stronger demand from the business sector and an increase in activity in the logistics arena will lead to greater hotel demand in industrial and urban areas.

On the contrary, pandemic forced companies to embrace a work-from-home scheme rapidly. Because of technology, this solution might be permanent. Corporations plan to let a significant part of their employees work from home after lockdown, implying a decrease in face-to-face meetings and an increase of online meetings. A contracting economy and the reduction of companies' gross profit will make it more difficult for the corporate segment to reactivate. Likewise, economic agents in each sector will exercise caution when exposing their workers to contracting the virus.

It is hard to tell when the REVPAR and Occupancy are going back to its previous levels. Therefore, in order for participants of the hotel industry to keep operating under atypical conditions, it will be of vital importance to maintain discipline in the management of resources. Industry agents must have an active behavior in face of a sanitary crisis and find internal mechanisms that comply with the international hygiene standards and, as a result, recover the consumer's trust. Flexible structures, available for rapid changes, will provide agents with advantages over passive competitors. Training of the staff and housekeeping personnel will be key to provide guests a sense of confidence and tranquility. Considering present and future market conditions, more than ever, corporations should increase cash inflow and delay cash outflows, as well as plan strategic decisions that guarantee liquidity to deal with potential opportunities.

The main concern in the Mexican Hotel Industry with the current COVID-19 pandemic is the lack of fiscal incentives to the sector. Restarting and starting costs, especially when it comes to construction, are very high considering that hotels are not highly profitable during the first years of operation. It would be ideal for hotels to receive fiscal incentives during their first years of opening or restarting operations. Another concern is clarity in the country for doing business. However, this concern is nothing new. Obtaining permits and licenses are among the most complicated processes for businesses, and investors often perceive these bureaucratic processes as an obstacle for investment.

States have presented their own measures to reactivate the overall economy. Sadly, there is no concrete federal countercyclical policies that incentivize a faster recovery aiming to the tourism industry.

² *Reshoring: the process of returning the production and manufacturing of goods back to the company's original country.*

³ *Nearshoring: the process of returning the production and manufacturing of goods back to a location that is less expensive and geographically closer.*

Economic Forecast for Mexico

The economy is set to suffer a great recession this year.

Factors affecting the economy are:

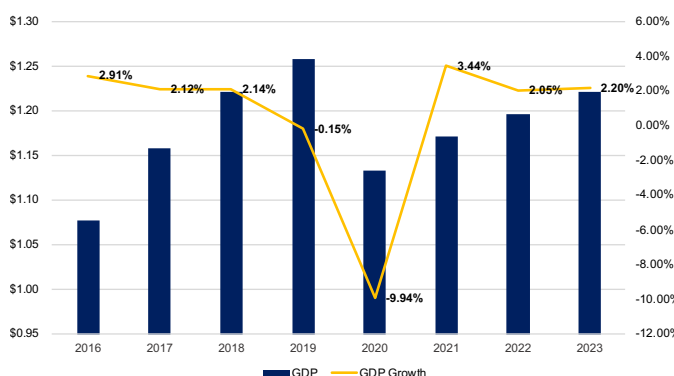
- Prolonged COVID-19 confinement;
- Mexican exports will definitely fall due to the drop-in world demand and in particular that of the United States (approximately 80% of Mexican exports in 2019 ended in the United States). Mexico is one of the world’s most trade dependent countries in the world and is highly dependent on exports to the U.S., which account for almost a quarter of the country’s GDP. The result is that the Mexican economy is strongly linked to the U.S. business cycle.
- An increase in the fiscal deficit is expected in 2020 as a result of less economic activity and therefore a possible increase in public debt.
- Lack of investor confidence with the current administration (Among the most controversial decisions of the current administration was the suspension of a long-awaited and under construction New International Airport in Texcoco -NAICM).
- Increase in risk country increase related to developing economies.

	GDP 2020	GDP 2021
Barclays	-8.8%	3.0%
Banorte	-9.8%	1.8%
Credit Suisse	-10.3%	2.0%
JP Morgan	-10.5%	5.5%
Citibanamex	-11.2%	4.1%
BBVA	-10.0%	3.7%
Santander	-10.0%	3.5%
UBS	-9.0%	4.4%
BANXICO	-9.9%	3.0%
AVERAGE	-9.9%	3.4%

*Forecasts to date 06/08/2020. Amounts in trillion dollars.

The economy is expected to contract -9.94% in 2020 and grow 3.44% in 2021 and 2.25% in 2022. A V-shaped recession is expected for the Mexican economy. The economy will suffer a pronounced decline followed by a recovery due to an improvement of macroeconomic conditions.

Gross Domestic Product



Source: Horwath HTL Mexico. Amounts in trillion dollars.

Ongoing economic and social concerns in Mexico include: a highly “monopolized” economy (telecommunications, oil, electricity and media monopolies), low real wages, underemployment for a large segment of the population, inequitable income distribution, violence related to the drug war (specifically at Border Cities with the US) and few advancement opportunities for the largely Amerindian population in the impoverished southern states (Chiapas, Guerrero, Oaxaca, Tabasco & Veracruz).

“With a population of almost 130 million, a rich cultural history and diversity, and abundant natural resources, Mexico has the 11th largest economy in the world. The country has strong macroeconomic institutions and it is open to trade and private investment.

The authorities have implemented stable and sustainable monetary and fiscal policies, which have made the Mexican peso the most highly traded emerging market currency.

Currently, it is the world’s 15th largest exporter due to the strengthening of its productive capacities, diversifying away from raw materials such as oil, and deepening its production complexity on manufactured products that are integrated into regional and global value chains.

However, despite all this progress, over the last three decades Mexico has underperformed in terms of growth, inclusion and poverty reduction compared to similar countries. Its economic growth averaged just above 2 percent a year between 1980 and 2018, limiting progress in convergence relative to high income economies.

On a per capita basis, average growth was close to just 1.0 percent. The country's per capita GDP today stands at 34.0 percent of U.S. per capita GDP, compared with 49.0 percent in 1980. In this context, progress towards poverty reduction has been moderate.

The total share of the population living below the monetary poverty line in 2018 was 48.8 percent, close to the level observed in 2008. The median per capita income (MePCI) has recently recovered slightly after several years of decline.

After a decline between 2010 and 2014, the annualized growth rate of MePCI in Mexico was 1.8 percent between 2016 and 2018, still well below the average for the LAC region.

Low growth rates and significant inequalities continued to raise the question of how Mexico can grow more rapidly and become more inclusive? These are the central issues covered in the recent Mexico Systematic Country Diagnostic (SCD).

But Mexico is a country with significant opportunities and potential. Its macroeconomic stability is the cornerstone to foster investments and a growing private sector.

Improvements in productivity growth, stronger institutions, and quality of service delivery and infrastructure, coupled with attention to reducing regional and household income inequalities, would bring shared prosperity. Its trade agreements, enviable geographic position, and growing domestic market, make Mexico a prime destination for investment"

Source: <https://www.worldbank.org/en/country/mexico/overview>

Resources

The resources used for this discussion include Reuters, Grant Thornton, World Bank, Moody's Analytics, IATA, Bloomberg, BBVA Research, Deloitte, Mexico Como Vamos, CNET, CICOTUR, OECD, SECTUR, GAP, ASUR, UNWTO, BANXICO, CONCANACO SERVITUR.

Supplement

Recovery Forecasts for the Mexican Economy:

Credit Suisse: adjusted a cut for Mexico's growth estimate to -9.6, from a previous -4 percent. According to the bank's analysts, the current economic environment will result in a deficiency in the industrial sector, which would fall as much as 35% due to a collapse in construction and manufacturing production.

Moody's Analytics: There is a 20 percent chance that the Chinese economy will collapse following the spread of the virus. In this way, the real growth of the GDP of the Asian nation would be 1.7 percent. However, the estimate indicates that, for the third quarter of the year, the real growth will be zero, which would mean China's worst economic performance in 30 years. Due to this situation, the global economy would also suffer significant consequences with a Gross Domestic Product of 1.1 percent growth for the period, which would translate into the worst performance since the financial crisis. According to Moody's, Southeast Asia and other emerging economies, including Mexico, would be the most affected, since their currencies would be pressured.

BBVA Research: We anticipate a fall in GDP of between 6.0% and 12.0% in 2020. Private consumption could fall by 7.1% due to social distancing measures and the negative impact on employment. A net loss of between 893k and 1.083 million formal jobs by the end of 2020 is expected, which would be a substantially higher job-loss figure than in 2009.

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Fabian Sanchez Cedillo is a Managing Director of Horwath HTL Mexico. He has participated in more than 1,000 studies in the United States, Mexico, Colombia, Brazil, Guatemala, El Salvador and Honduras for investment funds, banks and private investors. Over the years Fabian's clients have included Marriott International, Starwood, Hard Rock Hotel, Posadas, NH Hotels, City Express, GE Real Estate, Kimco Realty Corporation, Hines Interest, Walton St. Capital, Prudential, O'Connor Capital Partners, Thor Equities, Credit Suisse, Union Investment, Mexican REITs and numerous Mexican real estate developers.

Fabian previously worked as an Asset Manager for Grupo Posadas, one of the largest hotel developers in Mexico, where he was in charge of supervising the profitability of the hotel brands and was responsible for the opening of 15 new hotels in Mexico. From 1998 to 2002, he worked as a Senior Financial Analyst for Grupo Vector (Brokerage House), where he developed expertise in money markets and secondary markets in Mexico.

Fabian has a bachelor's degree in Economics at Instituto Tecnológico Autónomo de México (ITAM) and has been a part-time professor in Economics. He is member and speaker for the Urban Land Institute (ULI) and the International Council of Shopping Centers (ICSC), and has given conferences in San Antonio, Boston, Toronto, Las Vegas, Miami, Mexico and Cartagena. In 1997, Fabian received an MSc in Finance and Economics from Warwick University in England (UK).



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Valeria Aguirre joined Horwath HTL Mexico in 2019 as an analyst and is currently pursuing double bachelor's degrees in Finance and Economics at Instituto Tecnológico Autónomo de México (ITAM).

Valeria has completed numerous prestigious courses. In 2012, she received a special invitation to participate in Stanford University's annual Young Women's Leadership Summit. Her interest in academic research papers on economic issues led her to attend an academic writing course at the University of California in San Diego in 2015.

Prior to joining Horwath HTL, Valeria worked as a research assistant at ITAM and as a project manager trainee at Metlife. She is a member of Instituto Mexicano de Ejecutivos Financieros Universitarios (IMEFu) and has also participated in the organization of events and conferences at university.

Valeria is particularly interested in continuing education focused on the appraisal of tangible and intangible assets, market analysis, and feasibility studies.



Horwath HTL

Hotel, Tourism and Leisure

AFRICA

Ivory Coast
Rwanda
South Africa

ASIA PACIFIC

Australia
China
Hong Kong
India
Indonesia
Japan
Malaysia
New Zealand
Singapore
Thailand

EUROPE

Andorra
Austria
Croatia
Cyprus
France
Germany
Greece
Hungary
Ireland
Italy
Netherlands
Norway
Poland
Portugal
Serbia
Spain
Switzerland
Turkey
United Kingdom

LATIN AMERICA

Argentina
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Chile
Dominican Republic
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