A Report on

Market Data for Private Sector Investments in Nepal

Tourism Sector

Prepared By

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ABBREVIATIONS

BOT	Build Operate Transfer
CAAN	Civil Aviation Authority of Nepal
CAGR	Compounded Annual Growth Rate
D/E ratio	Debt Equity Ratio
DFID	Department for International Development (also UKaid)
F&B	Food and Beverages
FDI	Foreign Direct Investment
FY	Fiscal Year
GDP	Gross Domestic Product
GNDI	Gross National Disposable Income
GNI	Gross National Income
INR	Indian Rupee
IPO	Initial Public Offering
IRCTC	Indian Railway Catering and Tourism Corporation
JV	Joint Ventures
Ltd.	Public Limited
MCR	Market Capitalisation Ratio
MICE	Meeting, Incentive, Conference, and Exhibition
MoCTCA	Ministry of Culture, Tourism and Civil Aviation
MoU	Memorandum of understanding
NAC	Nepal Airlines Corporation
NATHM	Nepal Academy of Tourism & Hotel Management
NEPSE	Nepal Stock Exchange Limited
NHG	Nepal Hospitality Group
NPR	Nepalese Rupee
NRB	Nepal Rastra Bank
NRN	Non-Resident Nepalis
OFID	OPEC Fund for International Development
OPEC	Organisation of the Petroleum Exporting Countries
P.A.	Per Annum
PE	Price-Earnings Ratio
PLC	Public Limited Company
PPP	Public Private Partnership
PT	Perseroan Terbatas
RoE	Return on Equity
SAARC	South Asian Association for Regional Cooperation
SME	Small and Medium Enterprise
TR	Turnover Ratio
TVTR	Total Value Traded Ratio

UNWTO	United Nations World Tourism Organisation
US$	United States Dollar
USP	Unique Selling Proposition
VAT	Value Added Tax
VC	Venture Capital
WACC	Weighted Average Cost of Capital

BACKGROUND OF THE STUDY

The tourism industry creates significant economic impact in Nepal through direct and indirect activities, including GDP contribution, employment, and foreign exchange earnings, cross-sectorial synergies and induced spending. It is the 2nd largest employer in Nepal after the Agricultural sector, and the potential to truly drive inclusive growth in the country. The industry has been thriving with the recent political stability, and is expected to host nearly 1.5 million tourists by 2020. However the infrastructure-side of tourism is still inadequate – especially for servicing high value tourists. Several luxury hotels and resorts have come up in response to this market demand; driven by intrepid first generation entrepreneurs as well as established corporate groups. As elsewhere in the developing world, access to finance and technical know-how are the biggest constraint faced by hotel and resort promoters in Nepal. Private sector providers of risk capital such as venture capital funds, private equity funds, impact investors and venture debt funds can play a pioneering role in addressing the financing need as well as augment technical know-how with linkages to private tourism firms in emerging and developed economies. Early successes in investments can unlock further mainstream and domestic capital; and form the corner-stone of a strong and resilient private sector in Nepal.

One of the biggest challenges investors in Nepal face is a lack of clarity around market landscapes, business profiles, valuation benchmarks and exit opportunities. ***Market Data for Private Sector Investments in Nepal*** is a first of its kind attempt towards bridging this information divide. It seeks to act as a guide to foreign and domestic investors by providing insights into the landscape of private tourism activity in Nepal. These insights include structure and state of the sector, identification of promising investment opportunities, and evaluating capital flow and valuations in the sector. The report has been compiled using data from several credible sources, including existing research literature and industry publications. The secondary data was validated and additional information was gathered by engaging with key stakeholders in the sectors such as industry players, experts, financial institutions, policy makers, development finance institutions and sector associations. The report is constrained by limited consistent availability of data. In absence of hard and consistent data in some cases, the report relies on data from the field and relevant, triangulated proxy data from secondary sources.

METHODOLOGY AND APPROACH

The report is based on (a) primary data from interviews and focus group discussions with enterprises, experts and policy-makers and (b) secondary data from Dolma Impact Fund and relevant government and policy publications in Nepal. The report draws on data derived from sources such as Nepal government publications, data from World Bank and Intellecap's proprietary knowledge base. The report has been compiled using data from several credible sources, including existing research literature and industry publications. The secondary data was validated and additional information was gathered by engaging with key stakeholders in the sectors such as industry players, experts, financial institutions, policy makers, development finance institutions and sector associations.

The report is constrained by limited consistent availability of data across all sectors. In absence of hard and consistent data in some sectors, the report relies on data from the field and relevant, triangulated proxy data from secondary sources. It must also be noted that report does not extensively cover all the value chain elements in a sector - only promising, potentially high growth sectors are analysed. Users of this report should be cognisant of these data limitations.

CURRENCY EXCHANGE RATE

1 US$ = 94.19 Nepalese Rupee

Tourism in Nepal

Tourism industry contributes **8.2%** to GDP, provides **3.2%** direct employment, and **4.8%** of foreign exchange earnings

64.5% tourism revenues come from domestic tourists, and **35.5%** from foreign tourists; inbound tourism has been growing at CAGR of **6.65%**

Government is supportive of foreign investors; sector has seen over **US$ 125 million** in FDI since 2005

Attractive investment opportunities can be found in 4 and 5-star hotels and resorts; cumulative market opportunity of **US$ 80 to 100 million**

17% to 19% is the estimated hurdle rate for investments made in 4 and 5-star hotels and resorts in Nepal

1. Executive Summary

The tourism sector is an important contributor to GDP and employment in Nepal; and the overall outlook remains positive with growth in inbound and domestic tourism

The tourism sector in Nepal creates direct economic impact through GDP contribution, employment, and foreign exchange earnings; and indirect impact through cross-sectorial synergies and induced spending. The sector contributes 8.2% to the GDP, which is projected to increase to 11% in the next decade[1], and is the second largest employer after agriculture. The overall outlook for the sector is positive with growing inbound as well as domestic tourism, favorable investment climate, and growing private sector activity.

Significant demand-supply gap exists in tourism infrastructure, particularly in facilities for high-end tourists; which presents an opportunity for greater private sector engagement

There is a demand-supply gap in the tourism infrastructure in Nepal since the number of in-bound tourists has been increasing at a CAGR of 6.65% since 2007[2] but facilities to service them are inadequate in terms of quantity and quality. The demand-supply gap is especially wide in the "high-value" tourists' segment that seeks luxury accommodation and tours and travel services. There is a little focus on this segment given the overall thrust on "low budget tourism" in Nepal; and the sector would benefit from also bringing in focus on high-value tourists. Currently there are only 40 to 50 4 and 5-star hotels and resorts in Nepal, and most are concentrated in Kathmandu and Pokhara with very little high-end infrastructure outside these cities[3].

One of the key drivers of poor infrastructure on the supply-side is the low amount of capital investment in the tourism sector. Nepal reported capital investments worth US$ 0.1 billion in 2012 in this sector against a global average of US$ 4.2 billion[4]; pointing to a need as well as an opportunity for public and private sector actors to channel investments into this sector,

The regulatory regime is positive, and is expected to improve further in the near future

The regulatory regime in Nepal has positive impact on enterprise value and operations in the tourism sector through regulations that require hotels and resorts to meet international standards and subsidies and incentives for the private sector. However, these could be enhanced by bringing in more facilitative policies to encourage private sector entry in tourism industry – especially around land acquisition through public-private partnerships and build-operate-transfer models.

The Ministry of Culture, Tourism and Civil Aviation, is due to bring out a new 10-year National Tourism Strategy Plan and a 5-year Action Plan to act as a guiding framework for the tourism sector. The framework is expected to bring in several forward-looking policies for the private sector, especially in improving the business and investment environment, tourism infrastructure and public-private collaboration in marketing and branding initiatives. The strategy is expected to be rolled out in phases; with the first phase focusing on "diversification and improvement" from 2014 to 2018[5].

[1] World Travel and Tourism Council; Travel and Tourism Economic Impact; 2014
[2] MoCTCA, Tourism Statistics Nepal, 2012
[3] Intellecap analysis, 2014 - based on primary interviews conducted during the course of this study in May 2014; MoCTCA Tourism Industry Division, 2013 and Hotel Association Nepal website, accessed in May 2014.
[4] World Travel and Tourism Council, Travel and Tourism Economic Impact 2014
[5] UNWTO, Technical Cooperation and Services, National Tourism Strategy Plan for Nepal, 2014

The government encourages foreign investments in the tourism industry, and allows 100% FDI in most sub-sectors of tourism

100% Foreign Direct Investment (FDI) is allowed in most tourism sub-sectors except rural tourism, local catering services, travel agency, trekking agency, water rafting, pony trekking, horse riding and tourist lodging facilities[6]. As a result of the facilitative policy, over US$ 125 million of FDI has been channelled into the tourism sector by foreign entities from over 30 countries since 2005. Hotels and restaurants have been key focus sub-sectors for FDI in tourism, cumulatively accounting for 99% of the FDI inflows[7].

Analysing the structure of tourism industry in Nepal by type of services and purpose of tourism shows that 4 and 5-star hotels and resorts are the most attractive investment opportunity

The market opportunity for 4 and 5-star hotels and resorts in Nepal ranges from US$ 80 to 100 million, largely driven by inbound high-value tourists[8]. There are only 40 to 50 hotels and resorts in this category, and a significant demand-supply gap exists pointing to an opportunity for accelerated growth in this segment.

Other opportunities for private equity investors may also emerge in food service chains, travel-focused e-commerce, serviced apartments[9], and branded budget hotels

The tourism market in Nepal is growing at a rapid pace and can be expected to shift towards great modernisation and commercial-scale approaches over the next few years. Given this, investors can also expect to see interesting opportunities in businesses operating in segments like food service chains, travel-focused e-commerce, serviced apartments, and branded budget hotels in the near future. Some of these segments, especially food service chains, already show early traction in Nepal; while the others have succeed in neighbouring markets like India and are bound to transfer to Nepal through organic and inorganic routes.

Valuation of 4 and 5-star hotels and resorts in Nepal is challenging due to limited historical data; however this also gives early entrants in the private equity space an opportunity to buy stakes at lucrative prices

Valuation of 3 tourism companies listed (and actively traded) on the Nepal Stock Exchange (NEPSE) show ROE% ranging from 5 to 22%, EV/EBIDTA ranging from 6.72x to 25.91x, and P/E ranging from 6.64x to 35.18x[10]. These valuation multiples have been found to be in a wide range due to high volatility and risks perceived in Nepalese capital markets, as well as limited sample size, and given these limitations the valuation multiples for listed tourism companies cannot necessarily represent the industry benchmark in this sector.

The lack of data for valuation of tourism sector companies is primarily due to infancy of the investment value chain and support infrastructure such as research and ratings. Further, sparse research coverage of capital markets in Nepal has resulted in limited availability of historical data and limited access to updated industry benchmarks. However, the investment landscape is witnessing brisk activity, with 2-3 institutional investment funds setup over the last three years. This status of the

[6] Does not include starred-hotels
[7] Department of Industries, Industrial Statistics Nepal, 2013
[8] Intellecap analysis, 2014. See Sections 3.3 and 11.2 for details
[9] Furnished apartment available for hire, alongwith cleaning, cooking and other services as needed. Serviced apartments are typically used by medium to long stay travellers
[10] Calculated from company annual reports

investment landscape presents an opportunity for early private equity entrants to make investments at lucrative valuations.

In the absence of industry benchmarks for valuation; data from comparable SAARC countries and hurdle rates may be used as broad guides by investors

Valuation data from comparable SAARC countries like India and Sri Lanka may be used as broad guides by investors. However, investors should be cognisant that countries like India have much higher market capitalisation and better investment value chains. Hence, even though some comparable valuation ratios can be used from other developing SAARC countries, they can at best be broad guides since the regulatory regimes, banking infrastructure, market capitalisation and other macro-economic indicators vary widely from country to country.

In the absence of consistent data on valuation ratios in the sector, hurdle rate can serve a good indicator of minimum expected return from investments in the sector. Based on the data from the tourism sector in Nepal and comparable proxies, the Cost of Equity for investments in 4 and 5-star hotels and resorts is estimated to vary from 37% to 42%, and the Weighted Average Cost of Capital is estimated to vary from 17% to 19% for early-stage and growth-stage companies[11].

Private equity firms investing in 4 and 5-star hotels and resorts in Nepal may need to stay invested for 8 years or more before finding a lucrative exit

4 and 5-star hotels and resorts in Nepal generally take 5-8 years to breakeven and are expected to have higher trends in profitability thereafter[12]. Private equity investors should be cognisant of the projected break-even in specific opportunities to estimate lucrative entry and exit times. A successful exit will depend on the entry points of investments; which is usually the construction and/or expansion stage for a hotel/resort project. The requirement of capital is highest at this stage and investments can be made at lucrative valuations.

Promoter buy-back likely to be most popular approach for private equity exits in 4 and 5-star hotels and resorts segment in Nepal

Re-purchase of private investor's shared by promoter(s) is likely to be the more prevalent approach for exits in 4 and 5-star hotels and resorts since the business model enjoys high margins and has a high market opportunity as well. While promoter ability to buy-back will be one driver; the other will probably be the prevailing promoter sentiment where existing promoters want to ultimately retain complete control of the firm. There seems to be a high degree of apprehension about loss of control that could result from diluting management stake[13].

2. Introduction

Tourism[14] is an important industry in Nepal which from a socio-economic standpoint. It is a significant contributor to GDP and second largest provider of employment after agriculture[15], and is one of the

[11] Intellecap analysis 2014; see Section 10.3 for details

[12] From primary interviews conducted during the course of this study in May 2014

[13] From primary interviews conducted by Intellecap during the course of this study in May 2014

[14] Defined as "Tourism is a social, cultural and economic phenomenon which entails the movement of people to countries or places outside their usual environment for personal or business/professional purposes" by the United Nations World Tourism Organisation (UNWTO)

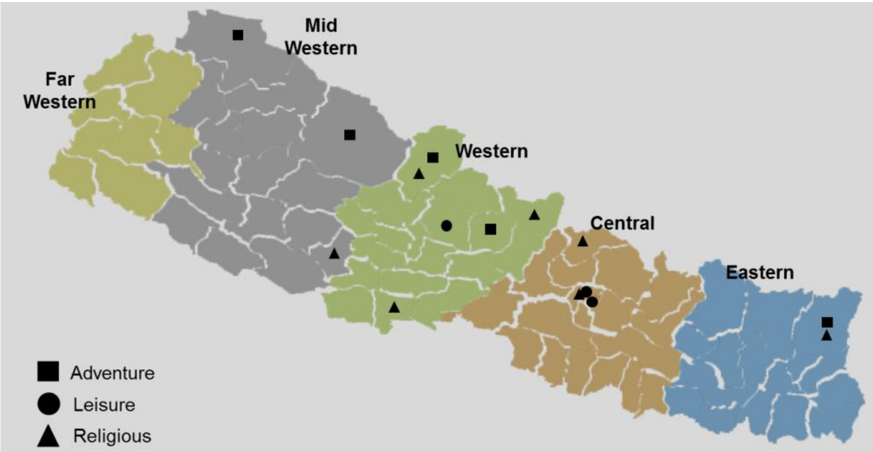
[15] See Section 2.1 for details

more developed services industries in Nepal. The sector spans urban as well as rural areas, and can play a crucial role in inclusive development.

"Tourism industry" in the context of this report is a collective term that encompasses providers of various travel-related services including accommodation, F&B services, shops, entertainment and adventure activity facilities, and other hospitality services available for tourists[16].

Tourism in Nepal is driven by a variety of "pull-factors" that attract travellers; including natural beauty, and spiritual and cultural heritage as shown in Figure 1. For instance, the country has 8 of the world's 10 highest peaks, is the birthplace of the Buddha[17], and has 9 world heritage sites - 2 natural and 7 cultural. The climatic conditions are also favourable with average spring and summer temperatures in the range of 20-24°C in popular tourist destinations like Kathmandu and Pokhara[18].

Figure 1: Distribution of key tourism destinations across Nepal



Source: Government of Nepal, Nepal Tourism Statistics, 2013

Even though Nepal is rich in natural and cultural heritage, it is one of the least developed nations in the South Asian region[19]. There is an opportunity to leverage this natural and cultural heritage to building a thriving tourism industry. Several countries in South East Asia like Thailand and Cambodia with similar contexts have successfully leveraged the tourism-opportunity to drive their economies and create more jobs[20]. Similarly, developing the tourism industry in Nepal can also help the economy grow, create jobs and improve quality of life of citizens. The public and private sectors can benefit from working in collaboration to achieve this end. Private sector support in the form of risk capital will be especially catalytic in building and scaling the tourism industry.

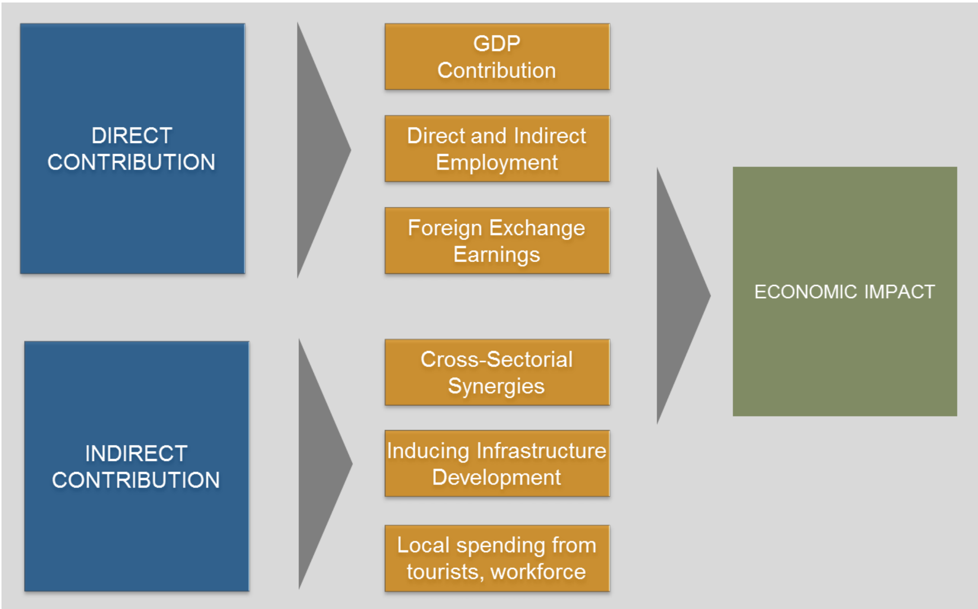
[16] Defined as "a person who is travelling away from their home base (city or country) for less than a year for a main purpose other than employment, and who spends at least 1 night in a private or collective accommodation in the area visited" by the UNWTO
[17] Gautama Buddha, also known as Siddhārtha Gautama, Shakyamuni, or simply the Buddha, was a sage on whose teachings the religion of Buddhism was founded
[18] Meteorological Forecasting Division, Department of Hydrology and Meteorology, Government of Nepal
[19] Nepal's Human Development Index ranking is 157 out of 187 countries; United Nations Development Programme's Human Development Report, 2013
[20] World Bank Development Indicators database, accessed in May 2014

2.1 Sector's Role in Economic Development

Tourism industry creates significant economic impact in Nepal through direct and indirect activities

The sector creates direct economic impact through GDP contribution, employment, and foreign exchange earnings; and indirect impact through cross-sectorial synergies and induced spending as shown in Figure 2.

Figure 2: Direct and indirect contribution of tourism industry to Nepal's economy



Source: Intellecap analysis, 2014

Tourism contributes 8.2% of Nepal's GDP today, which is projected to increase to 11% in the next decade

Tourism sector is a major component of Nepal's economy, and contributed US$ 1.6 billion to the GDP (8.2% of GDP)[21] in 2013. This contribution is predicted to increase at 4.5% p.a. to US$ 2.5 billion by 2023 (11% of GDP)[22]. Nepal's economy is more tourism-driven than neighboring SAARC countries. This is illustrated by the fact that direct contribution from this sector was 3.9% of total GDP which is significantly higher than neighboring countries. India and Bangladesh's direct contribution from the sector in 2013 was only 2% and 2.1% respectively[23].

Tourism employs 8.5% of the workforce, and is the second largest provider of employment opportunities after agriculture

In 2013, the sector employed 1.35 million people (8.5% of total employment) directly and indirectly; and this is forecasted to increase by 3.4% p.a. to 1.88 million by 2023[24]. The sector directly employed

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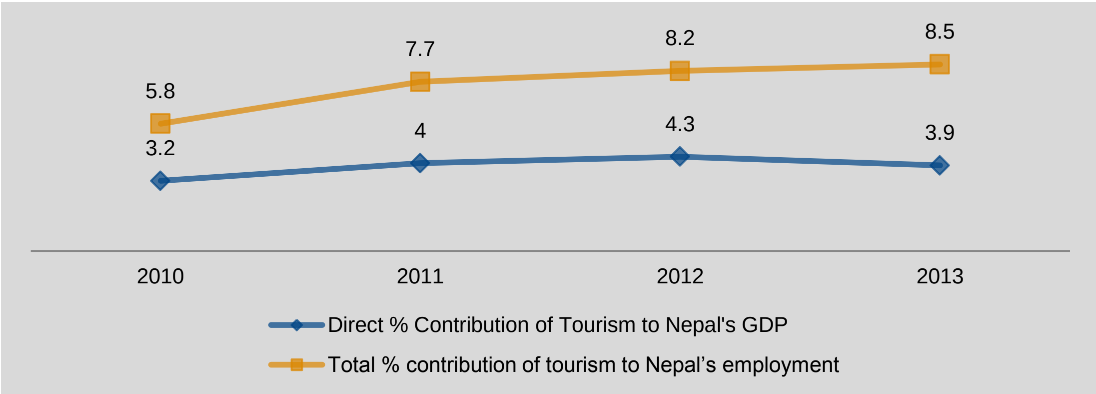
[21] This figure includes both direct and indirect contribution
[22] World Travel and Tourism Council; Travel and Tourism Economic Impact; 2014
[23] World Travel and Tourism Council; Travel and Tourism Economic Impact; 2014
[24] World Travel and Tourism Council; Travel and Tourism Economic Impact; 2014

0.5 million people (3.2% of total employment) in Nepal[25]; and this makes it the second largest provider of employment opportunities in Nepal after agriculture. However, the tourism sector in Nepal can also increase contribution to employment by shifting towards more organised and commercial-scale activity. For instance, Cambodia and Thailand - comparable South East Asian economies – note 6.6% and 8.9% direct contribution to employment. In terms of relative contribution in job creation, Nepal stands at 96th rank out of 184 countries, while its Cambodia and Thailand hold 25th and 38th rank respectively[26].

Overall, the tourism sector's contribution to GDP as well as employment generation have an shown increase over the past few years as shown in Figure 3. The government is supportive of the sector has committed to launching special programs and incentives for growth in tourism in the new Vision 2020 roadmap.

Figure 3: Contribution of Tourism to Nepal GDP and employment



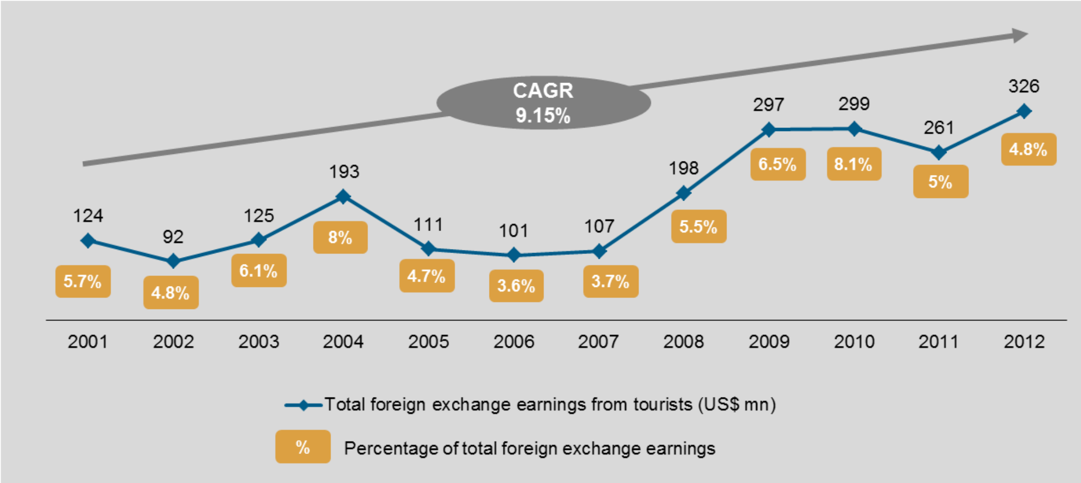
Source: World Travel and Tourism Council; Travel and Tourism Economic Impact; 2014

Tourism is also a significant source of foreign exchange earnings in Nepal; contributing 4.8% of total foreign exchange earnings in 2012[27]

The tourism industry is a significant contributor to foreign exchange earnings as shown in Figure 4. Tourism is Nepal can make substantial contribution to improve the adverse balance of payments resulting from Nepal's trade deficit with India and other countries[28].

[25] World Travel and Tourism Council; Travel and Tourism Economic Impact; 2014
[26] World Travel and Tourism Council; Travel and Tourism Economic Impact; 2014
[27] Government of Nepal, Nepal Tourism Statistics, 2012
[28] Nepal Rastra Bank, "Does Tourism Really Matter for Economic Growth? Evidence from Nepal", Paudyal 2013

Figure 4: Tourism sector contribution to foreign exchange in Nepal



Source: Government of Nepal; Nepal Tourism Statistics, 2012

Indirect contribution from tourism is nearly as much as direct contribution in low and middle income countries like Nepal[29]

Apart from its direct economic impact on the country through GDP contribution and employment, the sector also creates high degree of indirect and induced impact through cross-sectorial synergies with construction, infrastructure, handicrafts and other industries; inducing improvements in infrastructure like road and air connectivity; and through local economic transactions carried out by tourists as well as those employed in the tourism industry. In 2012, the indirect GDP contribution of tourism was 1.78x of direct contribution[30].

2.2 Overall State of Demand and Supply in Tourism

There is a demand-supply gap in the tourism infrastructure in Nepal since the number of in-bound tourists is increasing but facilities to service them are inadequate in terms of quantity and quality

The number of tourist arrivals in Nepal has been growing at CAGR of 6.65% since 2002[31]. However, the state of the supply-side in terms of facilities and infrastructure has remained stagnant. The current infrastructure of Nepal is insufficient to adequately service mid and high budget tourists. While NRB estimates that Nepal's existing infrastructure can service While Nepal Rastra Bank (NRB) estimates that Nepal's existing infrastructure can service 7.44 million tourists[32] as opposed to the current volume of 0.8 million[33]; this projection was calculated as a function of room nights available and does not take into account demand as per each tourist segment of budget, mid and high end. Further, most of the tourist activities are centred around 6-7 places which are preferred by tourism entrepreneurs and government for infrastructural development, but there is very little focus on diversifying to new destinations which may cause risk of "overcrowding" in existing tourist places in the short to medium term.

[29] World Travel and Tourism Council; Travel and Tourism Economic Impact; 2013
[30] World Travel and Tourism Council; Travel and Tourism Economic Impact; 2013
[31] Government of Nepal; Nepal Tourism Statistics, 2012
[32] Nepal Rastra Bank, Economic Activities Study, 2012-13
[33] Government of Nepal; Nepal Tourism Statistics, 2012

The wide demand-supply gap in tourism across various dimensions presents an opportunity for private equity investors to support businesses that are creating various types of solutions to address the gap[34]. The inflow of risk capital will not only help these businesses scale, but act as demonstration of the value in investing in tourism and encourage participation from domestic banks and angel investors. In the long-run; a thriving tourism sector can drive economic growth with trickle-down development outcomes in Nepal as already evidenced by contributions to GDP, employment and foreign exchange earnings.

2.2.1 Analysis of Demand-Side Dynamics

The demand for Nepalese tourism industry is influenced by 4 key trends in the sector – (a) growing contribution of domestic tourism (b) growing inbound tourism, (c) seasonality of demand, and (d) differing purposes of travel which dictates demand for different services.

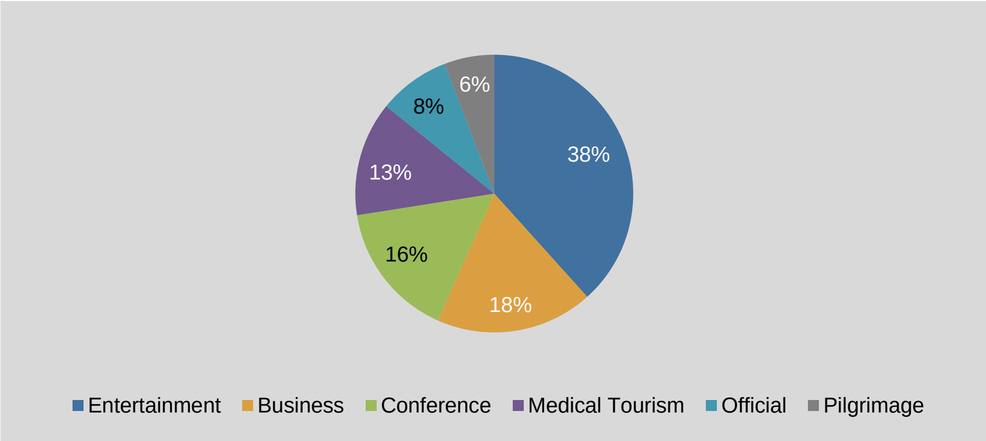
The tourism sector in Nepal is benefiting from growth in domestic tourism

Domestic tourism comprises 64.5% of total tourism revenues in Nepal[35], and includes spending for both leisure and business purposes. The growth in domestic tourism is a comparatively new phenomenon observed over the past 3-4 years, with more number of Nepalese citizens traveling locally to destinations like Pokhara and undertaking trekking and mountaineering activities. Industry practitioners interviewed during the course of this study[36] attribute this trend to three key drivers – changing demographic trends with more number of young people entering the market as consumers[37], government policies to promote domestic tourism amongst public sector employees[38], and improvement in tourism infrastructure. While limited government data exists on the overall trends, spending and preferences of domestic tourists; the Western Regional Hotel Association, estimates that domestic tourists arriving in Pokhara comprise over 35% of total tourists; a significant improvement from 2% composition a decade back.

On the flipside, the high-end luxury tourism industry currently does not see significant benefit from high-budget domestic tourists and such tourists still prefer to travel abroad for leisure[39]. In 2012, 150,000 Nepalese travelled to India, Thailand, Malaysia and Singapore for tourism purposes as shown in Figure 5. The tourism industry in Nepal could potentially grow faster by also focusing on capturing market share amongst these mid and high budget domestic tourists.

[34] Please see Section 6 for analysis of specific investment opportunities
[35] World Travel and Tourism Council, Travel and Tourism Economic Impact – Nepal, 2014
[36] See Annexure for complete list
[37] Government of Nepal, Ministry of Youth and Sports estimates that 38.8% Nepalese citizens are between 16 to 40 years in age
[38] See Table 5 for details
[39] From primary interviews conducted during the course of this study in May 2014

Figure 5: Nepalese Tourists going abroad; 2012



Source: Government of Nepal; Nepal Tourism Statistics, 2012

Nepal's tourism industry is also driven by foreign tourists, and their number has been growing due to political stability and demand-generation activities initiated by the government

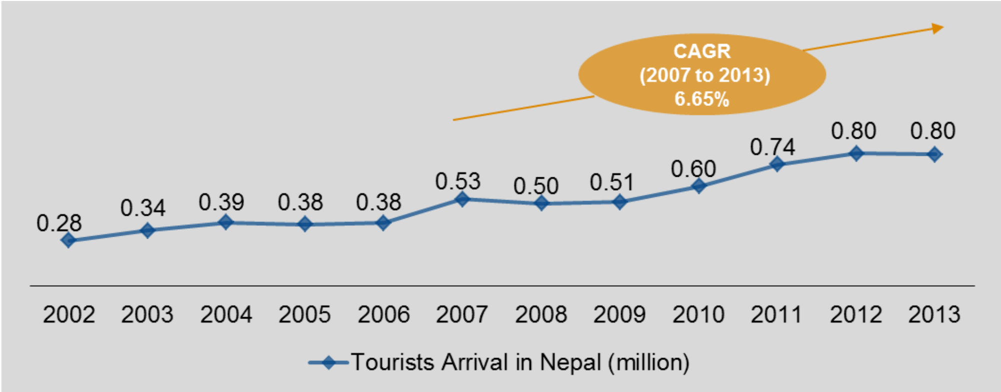
Foreign visitor spending forms 34.3% of total tourism spending in Nepal, which is quite high compared to 24% for Asia Pacific as a whole[40]. Tourists from India, China, Sri Lanka, USA and UK contribute over half of US$ 366 million spending in Nepal by foreign visitors.

Close to 800,000 tourists arrived in Nepal in 2013, and these arrivals have been growing at a CAGR of 6.65% since the cessation of civil conflict in 2006 as shown in Figure 6. The industry did witness a slowdown in growth from 2002-2007 owing to political and civil turmoil; but Nepal has successfully recovered; and increased the number of tourist two-folds in the past 6 years as a result of political stability and active efforts by the government to generate demand. For instance, Nepal government celebrated 2011 as Nepal Tourism Year and undertook large-scale marketing and promotions around the brand *"Naturally Nepal: Once is Not Enough"*, improved infrastructure and sought to diversify to new tourism market segments[41]. These activities led to a significant increase in number of tourists by 22% in 2011 and an increase of 9% in 2012[42]. With increased political stability and increasing government efforts, the number of in-bound tourists is expected to continue the upward trend.

Further, the visa policy liberalisation by India (which contributes 20.6% of total tourists[43]) and cross-border tourism promotion by public and private sector in China[44] (which contributes 8.9% of total tourists[45]) are also expected to further drive growth in in-bound tourism.

[40] World Travel and Tourism Council; Travel and Tourism Economic Impact; 2013
[41] Nepal Tourism Year 2011, Official Website
[42] Government of Nepal; Nepal Tourism Statistics, 2012
[43] Government of Nepal; Nepal Tourism Statistics, 2012
[44] MoCTCA and Chinese government representatives signed an MoU to improve air connectivity between the two regions in early 2014; as per reports released by Nepal Tourism Board
[45] Government of Nepal; Nepal Tourism Statistics, 2012

Figure 6: Tourists Arrival in Nepal (Million)

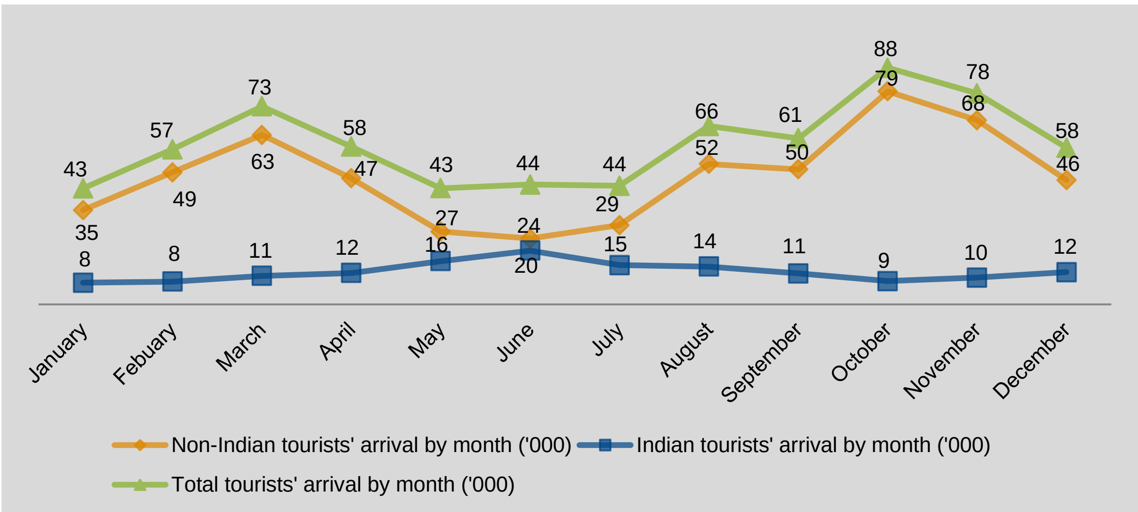


Source: Government of Nepal; Nepal Tourism Statistics, 2012 and World Travel and Tourism Council, Travel and Tourism Economic Impact –Nepal, 2014

Demand for tourism facilities shows seasonality in Nepal, with peak period in October and November; and lean period from May to June

The demand for tourism facilities in Nepal shows a degree of seasonality due to the climatic conditions. October to November; and February to April typically see good climatic conditions for travellers; while May and early June are hot and the monsoons from mid-June to September affects surface transport and visibility. An analysis of inbound tourism[46] in Nepal shows the highest influx is observed around October and November when maximum Indian and foreign tourists visit Nepal as shown in Figure 7. May to June is a lean period for tourist arrivals; although significant numbers of Indian tourists do visit Nepal even in this period[47]. Tourism industry can bring in special off-season prices and deals to further improve the number of inbound tourists from India during this time.

Figure 7: Number of tourists' arrival by month (average of 2010-12)



Source: Government of Nepal; Nepal Tourism Statistics, 2012

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[46] Defined as activities of non-residents travelling to a given country that is outside their usual environment, and staying there no longer than 12 consecutive months for leisure, business or other (corresponding) purpose; Helsinki: Statistics Finland; referred in June 2014

[47] This may be driven by the typical summer vacation cycle of May to July seen in schools and colleges in India

One-third of Nepal's in-bound tourists travel through India; indicating that the tourism industry in Nepal is dependent on India to a significant extent

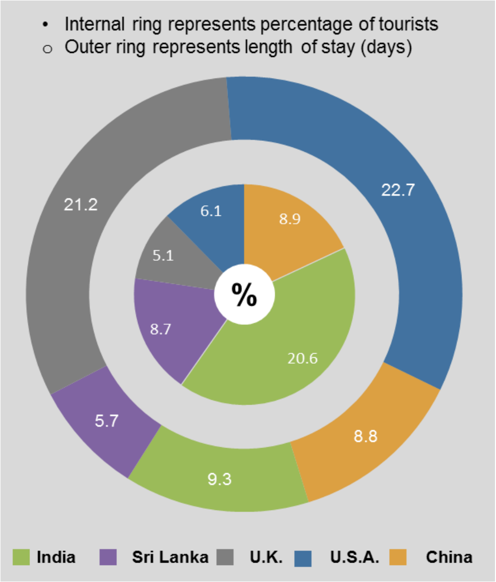
Nepal's tourism is directly impacted by the Indian tourism sector; as 30% of the foreign tourists visiting Nepal enter the country via India[48]. One of the biggest drivers of this trend is the limited air-connectivity between Nepal and international markets. Hence as the Indian tourism industry grows, a spill-over effect may be observed in Nepal as well. In 2012, India received 6.58 million foreign tourists, up 4.3% over the previous year[49]. Indian government's decision to extend the visa-on-arrival facility to travellers from nearly 180 countries in 2014 is a positive move from Nepal's perspective[50].

Five countries contribute to 50% of Nepal's in-bound tourists indicating need for improving branding among foreign tourists

Indian tourists form a major portion of Nepal tourism contributing around 20% to the industry because of the geographic proximity and low travel restrictions; followed by tourists from China, Sri Lanka, United States of America (U.S.A) and United Kingdom (U.K.).

In terms of length of stay, tourists from U.S.A. and U.K. spend nearly 22 days as shown in Figure 8, which is very high compared to Asian counterparts due to their preference towards trekking activities which demands more time. Such tourists tend to add significantly more value to the sector in terms of foreign earnings per tourist. Hence, the sector could benefit by focusing its efforts on attracting more tourists from these countries and regions.

Figure 8: Country wise split of percentage of tourists and length of stay (days) per tourist from top 5 source countries



Source: Government of Nepal; Nepal Tourism Statistics, 2012

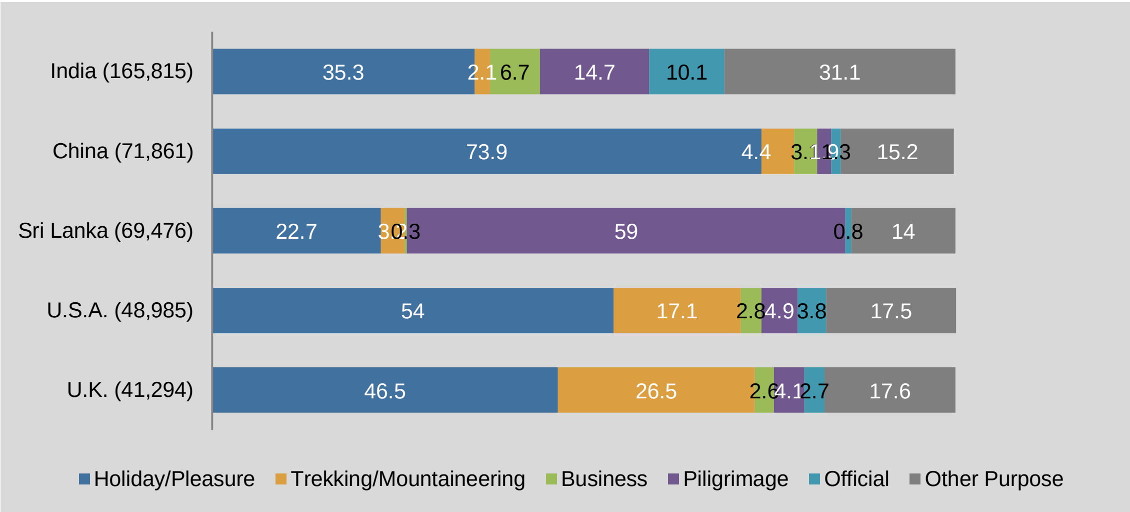
Tourists from different countries have different purposes of visit, with major purposes being leisure holidays, trekking and pilgrimage

48 Government of Nepal; Nepal Tourism Statistics, 2012
49 Ministry of Tourism; India Tourism Statistics; 2012
50 Zee News; via Press Trust of India; 2014

Tourists travel to Nepal for a wide variety of reasons; with 47% tourists seeking leisure holidays, 14% seeking pilgrimage and 13% seeking trekking. Other reasons for visiting Nepal include business, official, conference, conventions, exhibitions, study, research, and employment. There is a correlation between a tourist's country of origin and purpose of travel as shown in Figure 9.

Most Chinese tourists visit Nepal for leisure holidays. On the other hand, tourists from U.S.A. and U.K. tend to travel for adventure activities, and tourists from Sri Lanka travel for spiritual and religious purposes. This trend can be leveraged by the government and private sector by forging "purpose-specific" partnerships with travel agencies in these countries, and also tailoring branding campaigns based on the purpose of tourism.

Figure 9: Percentage of tourists by purpose of visit (top 5 countries), 2012



Source: Government of Nepal; Nepal Tourism Statistics, 2012

2.2.2 Analysis of Supply-Side Dynamics

The supply-side of Nepalese tourism industry shows 3 key characteristics – (a) high degree of fragmentation, (b) inadequacy of infrastructure to serve high budget tourists, and (c) low amount of capital investments

The tourism market in Nepal is highly fragmented; and overcrowding has been observed in some segments

The tourism sector in Nepal shows a high degree of fragmentation with a number of different small and medium companies offering accommodation, guided tours and other such services[51]. The low-budget accommodation and guided tours segment shows signs of overcrowding with large number of players offering undifferentiated services[52]. The fragmented nature of activity is a barrier to commercialisation and improvement in quality of the tourism industry; as too many small players are difficult for the public sector to regulate and for the private sector to invest in.

Public and private tourism infrastructure in Nepal is inadequate to address demand from high-budget tourists; the country still has positioning of a "low budget travel destination"

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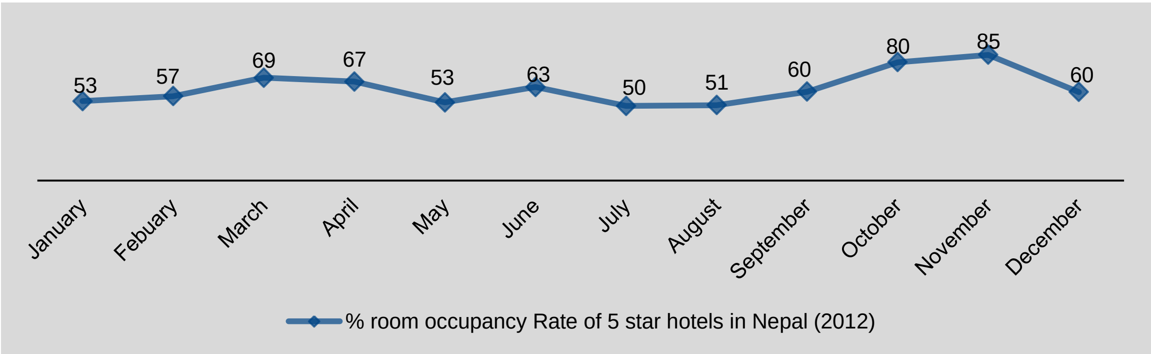
[51] Government of Nepal, Ministry of Finance, Economic Policy Network, "Focusing on Regional Tourism Markets: Prospects and Challenges for Nepal", 2006

[52] From primary interviews conducted during the course of this study in May 2014

The tourism infrastructure in Nepal, especially in terms of accommodation options and travel agencies is largely geared towards supporting low budget tourists. As a result, there is a shortage of high quality, branded service providers; specifically in accommodation and travel agency segment that can cater to the needs of mid to high budget tourists segment. This issue is further compounded by the underdeveloped state of roads, air travel, and safety/security. In combination, this dearth of high quality public and private infrastructure result in lower demand for Nepalese tourism amongst mid and high budget travellers.

Nepal has a shortage in the branded-mid and high budget accommodation segment and such facilities are often completely booked[53]; indicating that there is a market opportunity for expansion. For instance, occupancy in 4 and 5-star hotels and resorts was as high as 85% during peak season of October and November as shown in Figure 10.

Figure 10: Room occupancy rate of 5 star hotels in Nepal (2012)



Source: Government of Nepal; Nepal Tourism Statistics, 2012

Further, high budget tourists traveling to Nepal have a wide variety of interests ranging from adventure tourism to spiritual and leisure tourism[54]. However there are hardly any private travel agencies that can provide end-to-end high quality and dependable services for such diversity in interests.

Aside from inadequacy in accommodation and travel agencies, basic infrastructural facilities for tourists such as information centres are inadequate. The low level of development of roads, power and sanitation infrastructure also have a negative impact on consumer preferences of mid and high budget tourists.

Supply-side has a "missing middle" in high quality mid to high budget accommodation

The challenge of inadequate high-quality accommodation infrastructure is compounded by the fact that there is a "missing middle" in the hotels and resorts industry in Nepal where there is considerable demand for branded and credible 3 to 4 star hotels with per room night rate of US$ 50 to 100, but very little supply[55]. This gap can be addressed through branded domestic and international "no-frills" budget hotel that assure customers of a certain degree of service. For instance, a similar gap in the

[53] From primary interviews conducted during the course of this study in May 2014; and Government of Nepal; Nepal Tourism Statistics, 2012
[54] See Section 3.1.2 for details
[55] From primary interviews conducted during the course of this study in May 2014

early to mid-2000s in the Indian market led to entry of chains like Taj Ginger and Lemontree which cater to mid-budget business and leisure travelers at a per room night rate of US$ 45 to 100[56].

Nepal lags far behind global and South Asian averages in capital investment in the tourism sector

The country is ranked 126th globally in terms of attracting investment in tourism compared to India (4th), Sri Lanka (71st) and Bangladesh (83rd)[57]. Capital investments include spending by all the industries directly involved in the travel sector; and also include spending from other sectors which is of a “tourism nature” such as new visitor accommodation, transport equipment, restaurant and leisure facilities. Nepal reported capital investments worth US$ 0.1 billion in 2012 in tourism sector against a global average of US$ 4.2 billion[58]; pointing to the underdeveloped state of tourism infrastructure.

3. Sector Overview

The tourism sector in Nepal is over 60 years old[59], though organised and commercial scale activity started emerging only in early to mid-2000s. The industry is largely driven by foreign tourists, and due to the wide variety of tourist attractions in Nepal, the purpose of travel varies across tourists. Trekking is most important attraction for tourists and 13% of the tourists visit Nepal specifically for trekking and related activities. Adventure sports like rafting, paragliding and parasailing also form an important part of Nepal’s offerings to the tourists. Nepal offers a wide range of accommodation and F&B facilities for tourists ranging from 5 star hotels, luxury resorts, tourist standard hotels, and restaurants. It also offers homestays[60] in villages where tourists can stay with a local family and experience the rural Nepalese lifestyle. It is useful to analyse the tourism sector by both type of facility and purpose of tourism to understand the current state of the sector and identify high-growth areas.

3.1 Structure of Tourism in Nepal

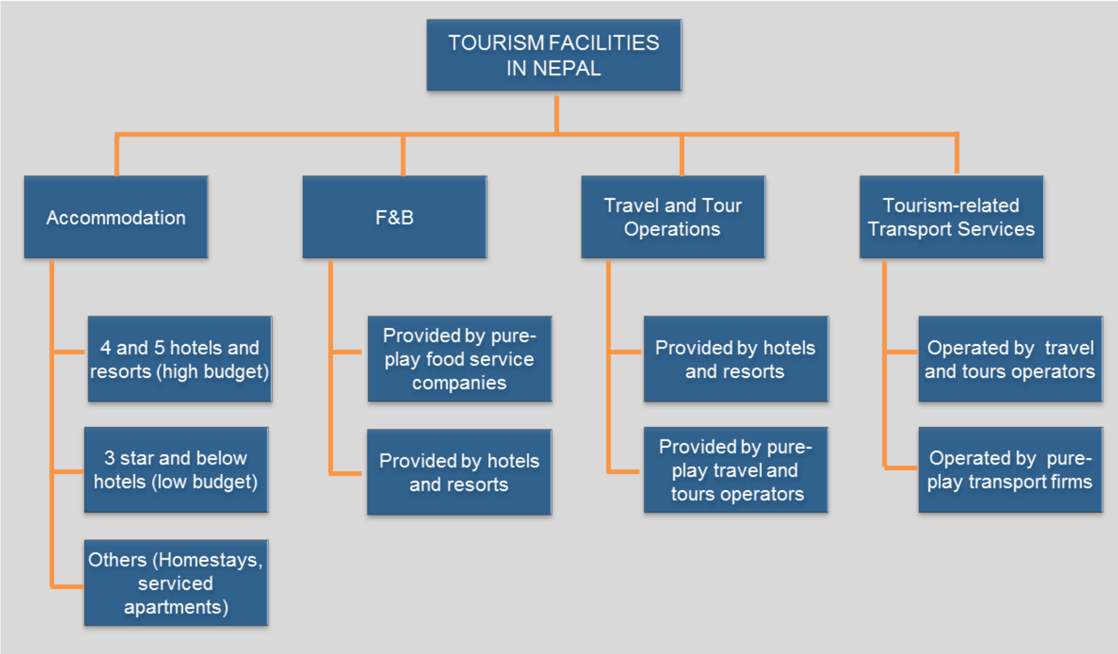
The tourism sector in Nepal can be analysed through 2 lenses – (a) types of facilities offered and (b) purpose of tourism.

3.1.1 Overview of Types of Facilities

Private sector activity in tourism can be analysed across the various types of facilities available to tourists. These facilities include accommodation providers, food and beverage (F&B) retailers and travel agencies as shown in Figure 11.

[56] From corporate booking websites of Ginger and Lemontree
[57] World Travel and Tourism Council, Travel and Tourism Economic Impact 2013
[58] World Travel and Tourism Council, Travel and Tourism Economic Impact 2013
[59] Himalayan Journal of Sociology and Anthropology; Volume 5; 2012
[60] Type of tourist facility that enables travellers to live with a local family for a specific and pre-determined fee. Homestays typically include boarding and lodging.

Figure 11: Types of tourist facilities in Nepal



Source: Intellecap analysis, 2014

Trend of vertical and horizontal integration has been observed in tourist facility providers

While each type of tourist facility listed in

Figure 11 is distinct and varies from the others; the larger providers of such facilities tend to overlap showing a trend of vertical and horizontal integration in the industry. For instance, tourist-transport services such as tourist buses, helicopters and private chartered flights are provided by pure-play travel companies as well as tour operators. Similarly, many accommodation providers also operate sister-companies focused on tour and travel operations.

3.1.1.1 Accommodation Providers

Nepal has accommodation options to cater to different budgets, ranging from luxury hotels and resorts to inexpensive lodges

Nepal provides a variety of accommodation to cater to different budgets, ranging from US$ 10 per day to US$ 200 per day. Accommodation options also show diversity in (intra-city) locations and facilities. The accommodation providers can be classified as luxury hotels and resorts (4 and 5-star hotels and resorts), budget hotels (3-star and below) and others (Homestays, serviced apartments) as shown in Table 1. Industry practitioners interviewed during the course of this study[61] reported high degree of informality amongst such low-cost accommodation providers; indicating that the actual number of such providers could be much higher than estimated by government data.

Table 1: Accommodation size in various categories of hotels and resorts in Nepal (2012)

	Total	Rooms
Five Star Hotels	**9 to 11**	**1500 to 1800**
Four Star Hotels	**30 to 35**	**3000 to 3500**
Three Star Hotels	**80 to 100**	**4000 to 5000**
Budget hotels[62] and homestays	**1,200 to 1,500**	**20,000 to 21,000**

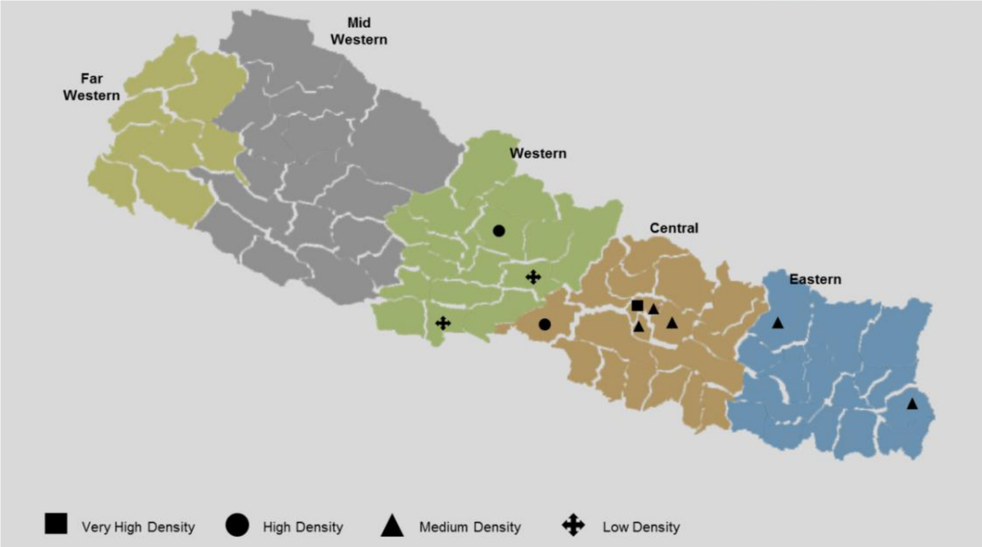
Source: Intellecap analysis, 2014 - based on primary interviews conducted during the course of this study in May 2014; MoCTCA Tourism Industry Division, 2013 and Hotel Association Nepal website, accessed in May 2014. Ranges have been used since the number of hotels compiled from different sources showed variation; as did the categorisation of hotels as 4 and 5 star. Further, the MoCTCA does not report on hotel distribution aside from Kathmandu Valley and hence government data is not available.

Most accommodation facilities for tourists are concentrated in 6-7 cities and towns, with little or no infrastructure outside these locations

Nepal tourism infrastructure is concentrated around Kathmandu valley, Pokhara and Chitwan region as shown in Figure 12. Lumbini & Sagarmatha base areas also have moderate number of hotels due to high influx of tourists in these areas[63]. While the fact that hotels are concentrated in a few areas presents a challenge; this challenge is further compounded by the fact that the luxury hotel segment is largely focused only on Kathmandu and Pokhara. High-budget travellers seeking to visit other towns and cities lack good quality facilities even though there is a willingness to pay. Given that there are 550-600 places of tourist interest[64] in Nepal, there is a huge opportunity for private sector participation in developing accommodation infrastructure in these underserved areas.

Figure 12: Nepal Map showing density of hotels across Nepal

[61] See Annexure for details
[62] Includes small and medium-sized lodges, guesthouses, and low-cost hotel facilities registered with the Department of Tourism
[63] Nepal Tourism Statistics, 2012
[64] Nepal Tourism Statistics, 2012; Tripadvisor Nepal; Intellecap analysis, 2014



Source: Intellecap analysis, 2014; based on primary interviews conducted during the course of this study in May 2014 and Nepal Tourism Statistics, 2012

The 4 and 5-star luxury hotels and resorts segment shows most organised and commercial-scale activity with several domestic and international brands present in the market

Even though the overall high budget or luxury accommodation segment is inadequate; the few players working in this segment show most organised and commercial-scale activity amongst accommodation-providers sub-category. This is mostly due to the high capital costs and entry barriers in building and running a hotel; which tends to discourage activity by smaller players in the high-budget luxury segment.

There are approximately 40 to 50 4 and 5 star hotels and resorts in Nepal; of which most are domestic brands. Some existing international brands include Radisson, Shangri La, Crowne Plaza and Hyatt Residency. Most of these hotels are located in Kathmandu and Pokhara as shown in Figure 12. According to the Ministry of Culture, Tourism and Civil Aviation (MoCTCA), 8 new star hotels and deluxe resorts are coming-up in different parts of Nepal shortly including some international brands. There is a likelihood that more foreign brand luxury hotels will come up in Nepal in the medium to long-term; structured as JVs, franchisee partnerships and management agreements[65]. For instance, Marriott International is also planning to enter Nepal and has signed an agreement with Nepal Hospitality Group (NHG). Other international hotel-brands expected to launch in Nepal in the next year or so include Sheraton and Hyatt.

Non-Resident Nepalis (NRNs) are already investing in hotels in collaboration with major international hotel chains[66]. The key benefits for NRNs include lower tax rate in Nepal, high potential for capital growth, welcoming regulatory environment, and a clear demand-supply gap in luxury hotels.

Nepal also has high end boutique hotels and resorts with fewer rooms but similar standards as 5-star properties

Along with 4 and 5-star hotels; Nepal also has some niche boutique hotels and resorts that have fewer rooms but provide similar or in some cases even higher standards of service. Such boutique properties are predominantly concentrated in Kathmandu and Pokhara, and their per room night rates can be higher than branded 4 and 5-star hotels. They typically have a Unique Selling Proposition

[65] From primary interviews conducted during the course of this study in May 2014
[66] See Section 5 for details

(USP) associated with them, such as unique view, being co-located with an important tourist attraction; and interiors featuring local art and craft among other USPs.

Some examples of such boutique hotels and resorts include Temple Tree Resort and Spa in Pokhara, and Dwarika's Hotel in Kathmandu. Temple Tree is located close to the Fewa Lake with 47 rooms and an average tariff of US$ 130 per night; while Dwarika's hotel is a heritage property with 86 rooms and an average room tariff of US$ 350 per night.

The 3-star and below budget and low-cost accommodation segment is fragmented and shows a high degree of informality

More than 75% of the hotels in Nepal are low-budget hotels; and this segment is highly fragmented. The total number of low-budget hotels in Nepal increased by 15.4% to a total of 1,224 in 2013; driven largely by low entry barriers and high influx of low-budget tourists. Such hotels compete with one another solely on pricing; and as a result of over-supply their occupancy rates and profit margins are low. Further, this segment does not offer significant opportunities for foreign investors since regulatory guidelines prohibit Foreign Direct Investment (FDI) in this segment[67].

Other emerging accommodation segments include homestays and serviced apartments

Homestays essentially entails living with a local family instead of a hotel or a resort. The concept of homestays is used in several developing countries like India to promote local art and culture, increase income for local communities and drive development of rural areas. The Nepalese government is also supportive of homestays and has initiated a program comprising of community homestay and private homestay for tourists[68]. As per official records, Nepal offers more than 100 homestays across the country[69]. However, this segment does not offer opportunities for foreign investors since FDI is not allowed.

Early traction has also been seen in the serviced apartments segment to cater to unmet demand for long-stay accommodation. There are relatively few alternatives to hotels and resorts for business or leisure travellers seeking longer-term accommodation in Nepal. Several industry practitioners interviewed during the course of this study reported that the serviced apartment segment could emerge and grow in Nepal as a response to this market demand over the medium-to-long term.

3.1.1.2 Food and Beverage Retailers

There are many F&B providers in Nepal including formal sector and informal sector players; the segment is driven by domestic demand as well as demand from foreign tourists

There are over 16,500 micro and small businesses in the F&B industry in Nepal[70], structured as shown in Figure 13 and also referred to as food service[71] companies. These are concentrated in urban hubs like Kathmandu and Pokhara; and the segment shows high degree of fragmentation and informality.

[67] Intellecap Primary Research; 2014

[68] United Press International; Homestays in Nepal boost tourism; 2012

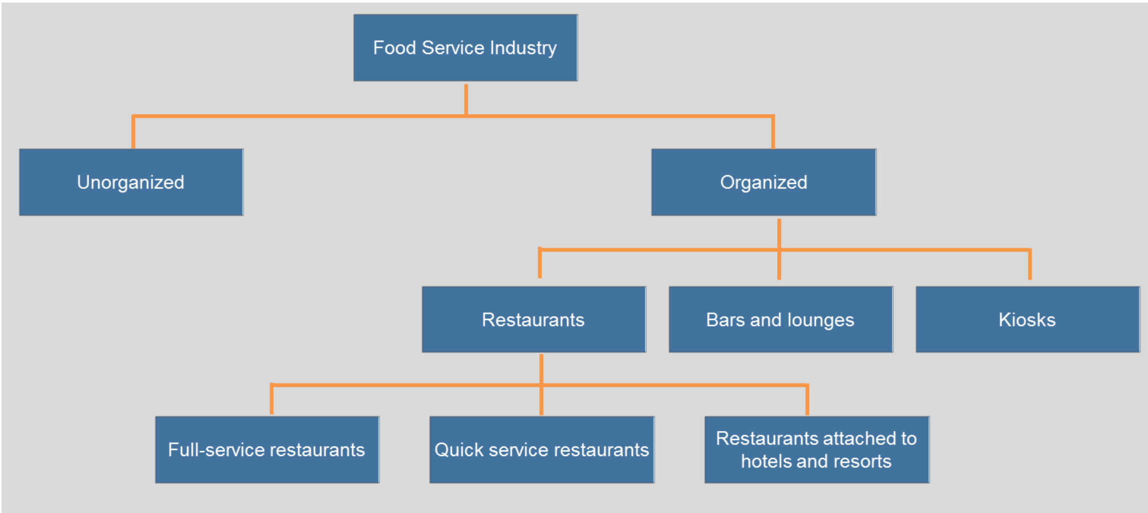
[69] Financial Express; Market-section; Nepal-gets-infrastructural-boost-for-tourism; 2014

[70] Concern for Children and Environment – Nepal estimated that on an average, there are 220 restaurants per district in Nepal; in their survey titled "National Survey on Child Labour in Restuarants"

[71] Includes businesses that retail prepared and/or cooked food through various delivery formats such as "at-home delivery", take-aways, sales from restaurants and cafes etc.

Key drivers of growth in the food service segment are domestic demand and demand from foreign tourists. A new middle class in emerging in Nepal which is driving higher retail consumption; and has also had a positive impact on the F&B market[72]. The Gross National Income (GNI) per capita has increased at a CAGR of 5.5% over past decade[73] and Gross National Disposable Income (GNDI) forms 25% of GNI[74]. The number of inbound tourists has also been growing at a CAGR of 11% as shown in Figure 6.

Figure 13: Structure of food services industry in Nepal



Source: Intellecap analysis, 2014

Amongst organised food service firms, only fine dining restaurants and those attached to hotels and resorts show a small degree of commercialisation

Amongst the organised food services industry shown in Figure 13; only restaurants show some degree of commercialisation but this activity is still nascent – with most restaurants having stand-alone models and structured as sole proprietorships. There are approximately 150 to 200 fine dining and quick service restaurants in Kathmandu alone; with more than 10 of these fine dining restaurants attached to 4 and 5-star hotels and resorts[75].

Limited activity has been seen in branded quick service restaurants, but this is expected to pick up in the next few years

Nepal has a limited number of foreign and domestic branded quick service restaurants (also called fast food chains). While foreign chains first entered the market in 2009, they have since been forced to exit due to labour unrest. On the other hand, the domestic quick service segment is still nascent and only 3-4 popular brands are seen in the market.

Foreign quick service restaurants were first brought to Nepal by Devyani International Pvt. Ltd.[76]; which opened KFC, Pizza Hut, and Cream Bell chains in 2009. However, labour unrest driven by

[72] Asian Development Bank, The Rise of Asia's Middle Class, 2010
[73] World Bank Development Indicators database, accessed in May 2014
[74] Department of Economics and Management; A better indicator of standards of living: The Gross National Disposable Income
[75] Hotel Association Nepal; primary interviews conducted during the course of this study in May 2014
[76] An associate company of RJ Corp which is a large India-based F&B firm

union activity forced these chains to shut down for a month in 2012. While business activities resumed after a month, the incident has served to raise the risk profile of foreign investments in the restaurant segment in Nepal.

On the other hand, domestic quick service restaurant segment is still nascent. Of the few existing chains, Himalayan Java coffee is one of the largest with 10 cafés spread across Kathmandu, Lalitpur, Bhaktapur, and Toronto (Canada). Other domestic quick service restaurants include Aangan which is a Joint Venture (JV) between Pashupati Foods Nepal and Bikanervala Foods India; and Gulab Sweets Nepal which is a subsidiary of Gulab Sweets in India. While Aangan has 6 outlets across Kathmandu, Biratnagar and Pokhara; Gulab has only one outlet in Kathmandu.

3.1.1.3 Travel and Tour Operations

Travel and tour operators' segment in Nepal is growing despite overcrowding in the market; with different firms showing low level of business model differentiation

Travel and tour operators in Nepal essentially operate through 3 models – (a) pure-play travel agencies; (b) tour operators; and (c) blended model with both travel agency and tour operator services. Pure-play travel agencies essentially act as "middle-men" between tourist facilities providers and tourists, but do not own any infrastructure. On the other hand, tour operators organise sight-seeing itineraries and often employ their own guides and own some infrastructure like transport; but rely on travel agencies for customer acquisition. Most large firms however employ a blended model of operations where they play dual roles of travel agencies and tour operations in order to make higher margins; with a specific focus on coordinating adventure and pilgrimage tours[77].

Overall, the travel and tour operations segment essentially includes service providers that help tourists with booking accommodation, transport, tours, and provides any other specific travel-related support that tourists may need. This segment acts as a "consolidator" in the tourism industry by bringing together diverse service providers and tourists.

Travel and tour operators segment in Nepal is growing at a CAGR of 10% every year[78] due to low entry barriers and low setup cost. It requires less than US$ 200 and 15 days to procure the requisite licenses[79]. As a result, there is high degree of price competition and firms face significant margin pressure. There were 2116 travel and tour operators in the country in 2012[80], an increase of 9.3% over previous year.

Such firms primarily operate through two models in Nepal – (a) stand-alone and (b) in partnership with foreign agencies. Majority of the travel and tour operators work in partnership with international travel agencies; where the former play the role of local mediators for connections to accommodation, guides and other services. A small minority of the travel and tour operators are standalone firms that offer self-designed tour packages and provide use their own networks to provide accommodation, transportation and other facilities. Industry practitioners interviewed during the course of the study reported that the profit passed on to domestic travel and tour operators from international agencies has seen a steady decline over the past few years[81]. This is a troubling trend for domestic firms that already face revenue and margin pressures due to overcrowding in the market.

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[77] From primary interviews conducted during the course of this study in May 2014
[78] Nepal Tourism Statistics 2012
[79] Nepal Business License e portal
[80] Nepal Tourism Statistics 2012
[81] From primary interviews conducted during the course of this study in May 2014

International travel agencies are also focusing on strengthening their services in the Nepalese market due to increasing inbound tourism

International travel agencies serve customers through easy-to-access websites and smart phone apps, and are able to offer lucrative packages and discounts due to their widespread networks of hotels and local travel agencies. They also offer crowd-sourced and expert-curated information on itineraries including essential sightseeing and activities for the tourists. International travel agencies are able to offer such value-added services in a profitable manner due to the scale of their operations; and hence offer tough competition for local players who may not be able to offer similar standards of service.

Most inbound tourists to Nepal prefer to book their flights and accommodation through international travel agencies like Expedia and Sixt[82]. Both entered Nepal in a substantial way in 2012, and are expected to drive bookings in the luxury tourism segment. As they create stronger networks in Nepal, their dependence on local travel agencies is decreasing and hence the profit-share that local travel agencies claim from transactions has also seen a decline[83].

There are very few large domestic travel and tour operators, and trend in vertical integration has been observed amongst these large players with several entering into the hotels and resorts segment

Partnerships between hotels and travel and tour operators are common-place in Nepal in order to provide end-to-end servicing for customers. However, a recent trend in vertical integration has been observed where larger travel agencies are also starting their own hotel businesses. With vertical integration, they are able to retain a higher share of the tourists' spending, and at the same time design attractively priced vacation packages with end-to-end servicing. For instance, Thamserku group, a large trekking holiday service company is working in close alliance with sister companies - Yeti Mountain Homes, Gokarna Forest resorts, Yeti Airlines and Tara Air to provide a complete set of offerings to tourists[84].

3.1.1.4 Tourism-related Transport Providers

Tourists in Nepal use both public and private means of transport for intra-country travel; and have access to road-based and air travel. Aside from intra-destination travel, transport is also often a tourist activity in itself – such as helicopter rides and ultralight flights for exploring natural beauty of peaks and mountains. In the private sector, such transport infrastructure is owned and operated by pure-play transport companies, as well as tours and travel operators. The latter tend to own and operate transportation that support their itinerary plans for sightseeing or adventure activities such as sky-diving.

While reliable data on the number of road-based transport is not available, the MoCTCA reports 15 domestic airlines, 2 skydiving companies, 3 ultralight companies, and 21 paragliding companies[85].

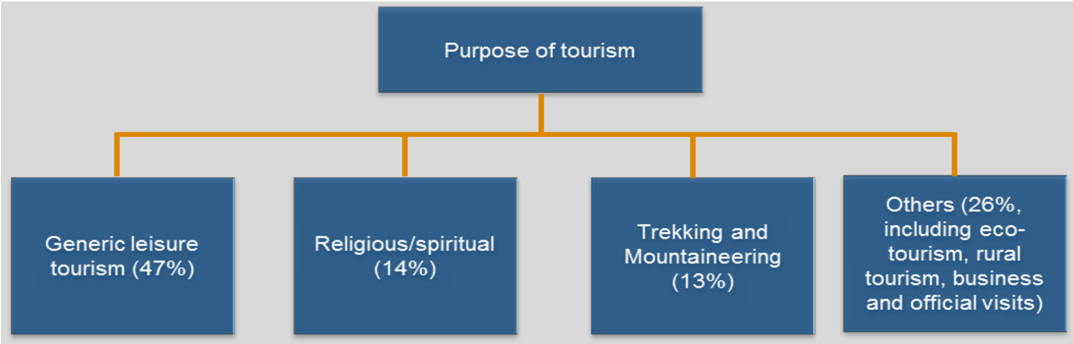
3.1.2 Overview of Purposes of Tourism

[82] From primary interviews conducted during the course of this study in May 2014
[83] From primary interviews conducted during the course of this study in May 2014
[84] Intellecap Primary research 2014; Thamserkutrekking website
[85] MoCTCA, Tourism Statistics Nepal, 2012

Tourists travel to Nepal for a wide variety of reasons ranging from leisure to pilgrimage as shown in Figure 14. Short-stay tourists[86] typically travel for either generic leisure tourism or pilgrimage purposes. Together they constitute over 61% of inbound tourists and are a key source of revenue for tourism facility-providers like hotels, restaurants and travel agencies. On the other hand, long-stay tourists[87] primarily travel for trekking and mountaineering activities and constitute 13% of inbound tourists.

Analysing the structure of the tourism industry using lens of "purpose of tourism" is useful to understand the "degree of specialised" tourist services available in the country. Overall, the current activity in specialised services is still at a nascent stage. However, given strong nature of demand this can be expected to grow in the medium to long term.

Figure 14: Purpose of tourism in Nepal



Source: Government of Nepal; Nepal Tourism Statistics, 2012

3.1.2.1 Generic Leisure Tourism

Nearly half of Nepal's inbound tourists travel for generic leisure purposes

Leisure tourism is the most important segment from a "purpose of tourism" point of view with 47% of the tourists visiting Nepal falling under this category[88]. India and China are the most important sources of inbound tourism in this category, with a combined contribution of 0.12 million tourists out 0.38 million tourists[89]. Nepal offers a wide range of leisure activities for leisure tourism, and the popular activities have been listed in Figure 15.

Figure 15: Different activities popular amongst leisure tourists

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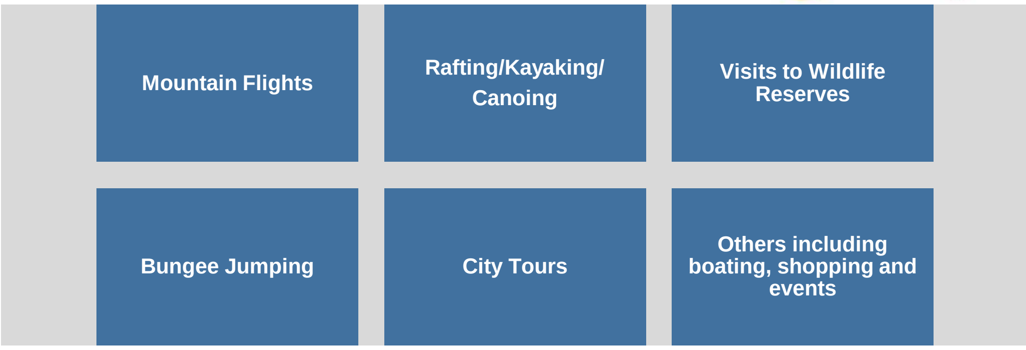
[86] Short-stay tourists refers to tourists who stay in Nepal for less than or equal to the average length of stay of a tourist in Nepal, which is 13.1 days according to the Tourism Ministry

[87] Short-stay tourists refers to tourists who stay in Nepal for more than the average length of stay of a tourist in Nepal, which is 13.1 days according to the Tourism Ministry

[88] Government of Nepal; Nepal Tourism Statistics, 2012

[89] Government of Nepal; Nepal Tourism Statistics, 2012



Source: From primary interviews conducted during the course of this study in May, 2014

Leisure tourism segment is crucial for tourism facility providers; especially hotels and resorts

Various small and large accommodation providers, travel agencies and F&B retailers depend on leisure tourists since 1 in 2 inbound tourists travels for leisure purposes. Since leisure tourists prefer to visit more popular destinations like Kathmandu, Pokhara and Chitwan, a large part of the clientele of hotels and resorts also fall under this category[90]. To further encourage the growth of this segment, the tourism industry would benefit from focusing on improving existing infrastructure to meet global benchmarks, and providing greater variety of end-to-end customisable tour packages for travellers.

3.1.2.2 Cultural, Religious and Pilgrimage Tourism

Nepal is an important destination for pilgrimage and cultural travel, and has 13 World Heritage Sites

Currently 14% of inbound tourists visit Nepal primarily for pilgrimage and religious purposes, while at least 56% visit cultural and religious sites while in the country irrespective of their primary purpose for travel[91]. Nepal has 13 World Heritage Sites[92], including Pashupatinath and Swayambunath temples in Kathmandu; Lumbini, the birthplace of Buddha; and Janakpur and Manakamana in Gorkha district[93]. These sites are especially important for those interested in Hindu and Buddhist faiths.

One of the more popular pilgrimages that the tourist sector in Nepal benefit from is the annual pilgrimage to Mount Kailash from May to November. Nepal is a transit point for this pilgrimage which ends in the Tibetan Autonomous Region. Thousands of pilgrims following Hindu, Jain, Buddhist, and Bön faiths make this annual journey each year, and industry practitioners interviewed during the course of this study reported a steady rise in their number over the past few years[94].

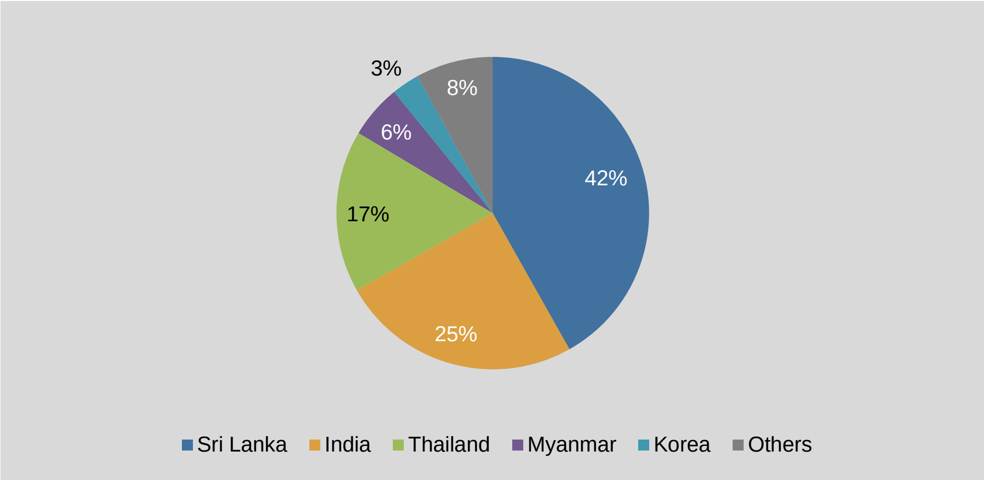
Most tourists visiting Nepal for religious and pilgrimage tourism come from Sri Lanka, India and Thailand as shown in Figure 16

Religious tourism is a lucrative segment for tourism facility providers as it is comparatively predictable and can be expected to rise during festivals. Further, some religious tourists can be expected in off-peak seasons also. The lucrativeness of this segment is also evidenced by the fact there was a rise of

[90] From primary interviews conducted during the course of this study in May 2014
[91] Government of Nepal; Nepal Tourism Statistics, 2012
[92] As recognised by the United Nations Educational, Scientific and Cultural Organisation (UNESCO)
[93] Government of Nepal; Nepal Tourism Statistics, 2012
[94] See Annexure for complete list of interviewees

72% over 2011 in the number of pilgrims to 0.11 million despite the overall industry increasing just by 9% that year.

Figure 16: Tourists visiting Nepal for pilgrimage, 2012



Source: Government of Nepal; Nepal Tourism Statistics, 2012

Poor state of infrastructure in religious destinations is a threat for future growth; can be tackled by collaboration between public and private sectors

While this segment shows promise, its growth could be negatively impacted by the poor state of infrastructure in many important religious destinations – both within specific monuments, as well as in the general vicinity. The tourism sector in Nepal can benefit from increased focus on improving the overall state of religious destinations, particularly through investments in infrastructure like hotels and roads; and in services like waste management. Since these are capital-intensive undertakings, the government could explore partnerships with private sector to jointly approach such projects.

For instance, in India, religious destinations like Tirupati (in the South Indian state of Andhra Pradesh) have seen collaborative state government and private sector projects to improve the state of infrastructure and develop adequate facilities for pilgrims. Driven by the efforts, Andhra Pradesh became top tourist destination in India recording 206.8 million domestic tourists in 2012[95].

Overall, despite challenges like under-developed infrastructure in most of the religious tourist areas, this segment is growing at a high rate and is expected to continue to grow in future. This growth can be accelerated by increased public and private sector attention towards solving infrastructure-related challenges.

3.1.2.3 Trekking and Mountaineering

Inbound tourists who seek trekking and mountaineering related activities spend 40% more than other tourists on average

Trekking forms an important part of Nepal tourism with 8 out of 14 of the world's highest peaks located in Nepal. Out of 0.8 million inbound tourists in 2012, 13.1% visited for trekking and mountaineering activities, an increase of 21.7% over the previous year. October and April are most

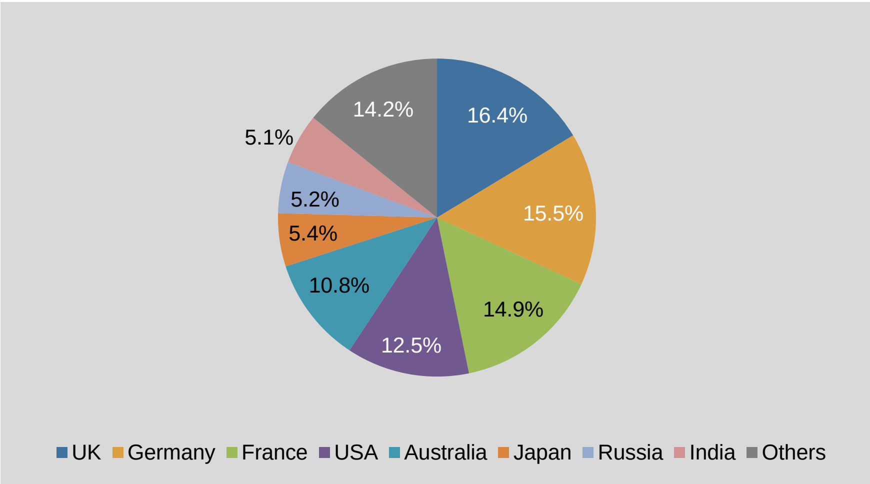
[95] Ministry of Tourism; India Tourism Statistics; 2012

suitable months for trekking in Nepal with half the trekkers visiting during these months. Adventure tourists from North America, Latin America and Europe spend 40% more than other travellers per trip excluding airfare[96]. Mountaineers that seek to climb tough peaks like Everest stay in Nepal for more than 45 days on average, and spend more than US$ 40,000 per head[97]. Hence this segment is important for the tourism industry in Nepal, both for increased revenue and for increased foreign exchange.

UK, USA, Germany and France contribute 60% of inbound tourists focused on trekking and mountaineering as shown in Figure 17

Tourists from UK, USA, Germany and France form a major portion of trekkers in Nepal with nearly 60% trekkers coming from these countries. Public and private tourism promotion efforts in the European region would benefit from taking this fact into cognisance and focusing on "adventure travel" oriented messages and packages.

Figure 17: Tourists visiting Nepal for Trekking and Mountaineering (2012)



Source: Government of Nepal; Nepal Tourism Statistics, 2012

Regulations and infrastructure to drive safe practices and waste management in mountaineering and trekking will help towards sustainable growth in this segment

While mountaineering and trekking are inherently risk-prone activities; tourists in Nepal are at a high risk of injury or even death due to the tough terrain of the Himalayas, frequent avalanches, poor early warning and rescue infrastructure, and laxity in regulation around safety. The tourism industry will benefit from self-regulation and public-private investments in improving safety infrastructure. An additional element to regulation is to also monitor the number of people permitted to climb each peak. In the past 4-5 years, over 2000 mountaineers have scaled Everest[98]; an alarmingly high number that

[96] Adventure travel trade organisation; Adventure tourism market report; 2010
[97] Government of Nepal, Ministry of Tourism, Preliminary Statistics for 2013
[98] Government of Nepal, Ministry of Tourism, Preliminary Statistics for 2013

the current infrastructure as well as the natural terrain cannot support sustainably. With the government further reducing fee for mountaineering licenses[99]; this number is also expected to grow.

A second safety-related issue for mountaineering and trekking industry in Nepal is to bring out stronger and more comprehensive regulations regarding the hiring, payment, and services expected from professional guides (also called Sherpas). Isolated incidents of tension between guides and tour operators as well as tourists have reported in the media as well as during primary interviews; and the industry would benefit from addressing these issues in a fair manner so as to satisfy the guides as well as tourists and tour operators.

Another threat to the long term growth of this segment is the poor state of waste management practices, especially around the more popular destinations like Everest Base Camp. Industry practitioners estimate that over 50 to 75 tonnes of garbage is dumped in and around the Everest Base Camp area, which includes bio-hazards like human waste and dead bodies[100]. A recent government regulation which requires climbers to return from the peak with at least 8 kilograms of waste[101] is a welcome move, but in the absence of monitoring infrastructure the compliance is fairly low[102]. More public-private collaboration to manage the challenge of waste in Nepalese Himalayan region, coupled with a stronger regulatory regime can ensure long term sustainable growth in mountaineering and trekking in the country.

3.1.2.4 Others

Other less common purposes for tourism in Nepal include ecotourism, rural tourism, and MICE (Meeting, Incentive, Conference, and Exhibition) activities; while these are currently nascent they have the potential to emerge as lucrative segments in the future

Ecotourism is slowly picking up pace in Nepal; driven by natural beauty, flora and fauna in the country

The International Ecotourism Society defines ecotourism as “Responsible travel to natural areas that conserves the environment and improves the well-being of local people”. This segment in Nepal primarily consists of wildlife viewing, wilderness camps, hiking vacations and white-water rafting[103]. Nepal is blessed is home to 5833 species of gymnosperms and flowering plants with some 315 endemic species of higher plants; 847 bird species; 185 mammal species; 43 amphibian species; 100 reptile species; 656 butterfly species and 185 fresh water fish species[104]. This degree of biodiversity is unusual in a relatively small nation (in terms of land area) like Nepal; and is the key driver of ecotourism in the country. Many travel agencies in Nepal offer a variety of eco-tours ranging from a few hours to several days in duration. However, due to limited tourism infrastructure like eco-camps, this segment currently does not attract a significant number of high-end tourists. The industry can benefit from investments in eco-tourism infrastructure; as well as in protecting Nepal’s biodiversity and environmental heritage.

Rural tourism in Nepal is primarily driven by the concept of Homestays; and the segment sees a fair degree of overlap with purposes like ecotourism and mountaineering

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[99] Government of Nepal, Ministry of Tourism website, accessed in May 2014
[100] From primary interviews conducted during the course of this study in May 2014
[101] Government of Nepal, Ministry of Tourism website, accessed in May 2014
[102] From primary interviews conducted during the course of this study in May 2014
[103] From primary interviews conducted during the course of this study in May 2014
[104] Nepal Official Website; ecotourism

Rural tourism in Nepal essentially provides tourists with the opportunity of living a typical Nepalese rural lifestyle with a village-based family, and taking part in activities that they perform. Such tourism is generally “facilitated” by travel agencies that identify the village, Homestay, and create an itinerary of engaging activities for tourists including handicraft-making, meditation, treks and involvement in typical rural household chores. Such travel agencies have strong relationships with the host village and enter into revenue-sharing agreements with specific households for accommodation as well as rural tourism activities[105]. This segment is currently small-scale, but is being actively encouraged by public sector and philanthropic organisations for augmenting livelihoods of villagers and thereby increasing access to better nutrition, healthcare and education. The regulatory regime currently prohibits FDI in rural tourism to protect the local industry[106]. In any case, firms engaged in rural tourism are not operating at a scale that can allow them to absorb institutional private equity capital.

Nepal can be developed as a world-class MICE (Meeting, Incentive, Conference, and Exhibition) destination for business as well as entertainment purposes

Nepal is also gradually emerging as a popular meeting destination for business conferences, exhibitions, and personal events like weddings. Private sector infrastructure includes existing conference facilities specially meant for MICE activities and several 4 and 5-star hotels in Kathmandu also provide meeting facilities that are comparable to international standards. There are some significant bottlenecks to growth of the MICE industry however, including – (a) the lack of “clustering” of conference, accommodation and entertainment facilities seen in successful MICE destinations like Dubai; (b) the poor state of air connectivity between Nepal and most other countries aside from India; and (c) inadequacy of current infrastructure to support very large gatherings of more than 10,000. Addressing these challenges can help to develop an additional lucrative segment of tourists in Nepal; especially for high-end hotels and resorts.

3.2 Current State of Tourism Industry in Nepal

The current state of tourism sector differs across sub-sectors, with some like luxury hotels and resorts showing more organised and private scale activity; as well as high firm-level competitiveness than others

The current state of the tourism sector can be analysed across 3 factors – (a) level of organised and commercial scale activity in the private sector, (b) degree of overcrowding, (c) overall firm-level competitiveness and (c) ability to take in private equity capital as shown in Figure 18. While lenses (a), (b), and (d) are positive indicators; less (c) is a negative indicator. These 4 lenses have been identified based on the objective of this market study – which is to present an overview of the investment landscape in tourism and identify viable investment opportunities.

Figure 18: Market-level competitiveness in the tourism sector in Nepal

[105] From primary interviews conducted during the course of this study in May 2014
[106] Government of Nepal, Ministry of Tourism

Key Sub-sectors	4 and 5 star hotels and resorts	3 star and below hotels	Homestays and Serviced Apartments	Stand-alone food service companies	Chains of food service companies	Tour and Travel Operators	Specialized purpose driven tourism (e.g. MICE)
Level of organized and commercial scale activity in the private sector	Moderate	Low	Low	Moderate	Low	Low	Low
Degree of overcrowding in the market	Low	High	Low	Moderate	Low	High	Low
Degree of firm-level competitiveness	High	Low	Low	Moderate	High	Low	Low
Ability to take in private equity capital of US$ 0.5-5 million as minority stake	High	Low	Low	Low	Moderate	Low	Low

High
Moderate
Low

Source: Intellecap analysis, 2014

Four and five star hotels and resorts depict high level of organised and commercial scale activities along with a low degree of competition; present lucrative opportunities for private equity investors

Four and five star hotels and resorts high enjoy high occupancy levels as there are less than 20 such branded properties in Nepal. Due to oligopoly and less competition, they are able to realise high profit margins. Those with foreign brand tie-ups also enjoy a distinct edge over others in attracting bookings, especially through international travel agencies. As the number of inbound tourists continues to grow, the occupancy and revenues of these hotels will also see an uptick. Further, currently available data on number of upcoming projects (discussed in Section 3.1.1.1) indicates that there is low probability of overcrowding in this segment.

Given the scale of these companies, they are also able to absorb private equity capital as minority stakes; and hence present lucrative opportunities for private equity investors.

Budget hotels and travel agencies in Nepal are overcrowded and fragmented; not lucrative for private equity investments

The budget hotel segment is fragmented with significant degree of informal activity. Even though this segment is growing, the government does not allow FDI in hotels below 3 star levels[107]; and in the absence of commercial capital and know-how, this segment is not expected to develop and commercialise in the medium term. A similar trend of overcrowding and fragmentation is seen in travel agencies as well which are mushrooming in important tourist destinations as a result of low entry barriers. Both these segments cannot take in private equity capital structured as minority stakes and are not viable for private equity investments unless a trend of consolidation emerges.

[107] Intellecap Primary Research, conducted in May 2014

Stand-alone F&B providers show moderate degree of organised and commercial-scale activity, as well as firm-level competitiveness; but cannot absorb institutional private equity capital

While stand-alone F&B providers do show some positive indicators of growth; nearly all are still micro and small-scale businesses structured as sole proprietorships. They have neither the size nor the managerial wherewithal to absorb private equity capital and deliver returns to investors. Some notable exceptions to this trend are chains of quick service restaurants emerging across Nepal, especially in the cafés segment. However such activity is restricted to a handful of firms and does not represent the general state of this segment. As the tourism and retail sectors in Nepal evolve, and a growing middle class increases demand for F&B services; it is expected that this segment may grow in the future and emerge as a high potential segment with lucrative investment opportunities.

Specialised tourism providers such as homestays and serviced apartments are nascent with unproven market traction and viability; hence these are not lucrative options for private equity investors at present

As these segments grow and start to show some traction, they may emerge as viable investment opportunities in the future; but current levels of activity do not warrant entry of private equity investors in these segments.

Since analysis shows luxury hotels and resorts as the only currently viable opportunity for private equity investors in the tourism sector in Nepal; this segment will be detailed out further in Sections 4 to 10 of this report.

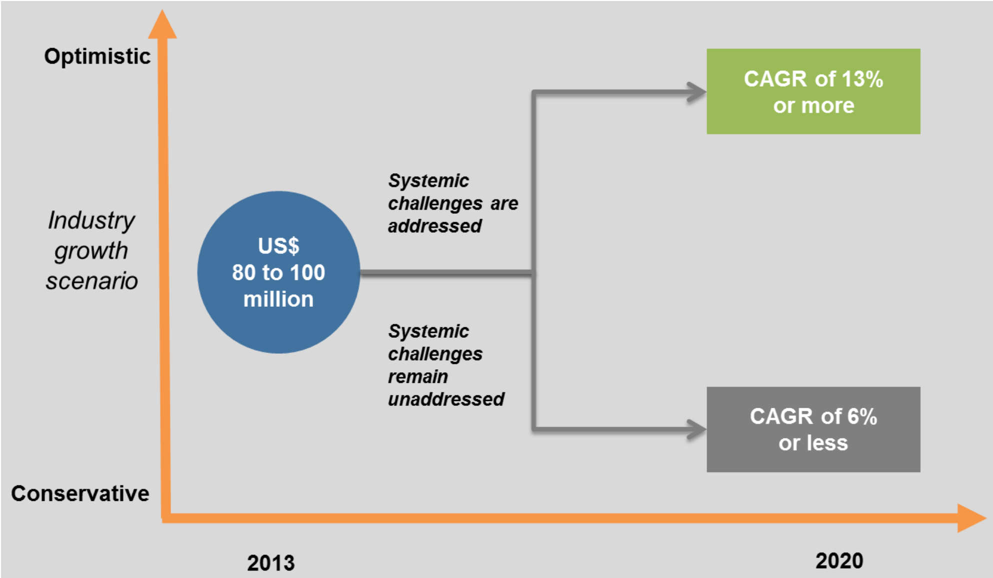
3.3 Market Opportunity

4 and 5 star hotels and resorts have a current market size of US$ 80 to 100 million in Nepal

According to insights gleaned from industry practitioners interviewing during the course of this study, the demand for 4 and 5 star hotels and resorts in Nepal is driven primarily by high budget foreign inbound tourists. Such high-budget tourists currently comprise 18 to 20% of inbound tourism; and represent a potential market opportunity of US$ 80 to 100 million for 4 and 4 star hotels and resorts[108] as shown in Figure 19.

[108] See Annexure for methodology

Figure 19: Market opportunity for luxury hotels and resorts in Nepal



Source: Intellecap analysis, 2014

If the systemic challenges plaguing tourism industry remain unaddressed; then the market opportunity is likely to show slower growth at a CAGR of less than 6% over the next few years

During last six years, the tourism industry has seen a significant growth in inbound tourism[109] which has also created a positive impact on luxury hotels and resorts. However, the sector faces several systemic challenges that can drive the market for luxury hotels and resorts to grow slowly – with neither inbound tourism nor number of high-budget tourists showing significant uptick and continuing to show current trend of 6.65% CAGR in inbound tourism[110] and 18 to 20% component of high budget tourists[111]. In such a scenario, the market opportunity is likely to show growth of less than 6% CAGR over the next few years[112]. These challenges include the poor state of air and road travel infrastructure; inadequacy of infrastructure to serve demands of high-budget tourists; and macro-level risks like political instability, natural calamities, and environmental degradation[113].

If public and private sectors make progress in addressing systemic challenges plaguing tourism, then the market opportunity is likely to show high growth of 13% CAGR in Medium to long term

An optimistic CAGR is a possibility in Nepal; because the tourism sector has previously shown a high year-on-year growth of 22% from 2010 to 2011 driven by public and private sector efforts around the "Nepal Tourism Year 2011" campaign[114]. If a similar focused thrust is made towards increasing inbound tourism on one hand; and driving investments and resources towards improving tourism and transport infrastructure on the other; then both inbound tourism may see an uptick and grow at 10% CAGR[115] over the next few years. Further, the number of high-budget tourists may also see an uptick

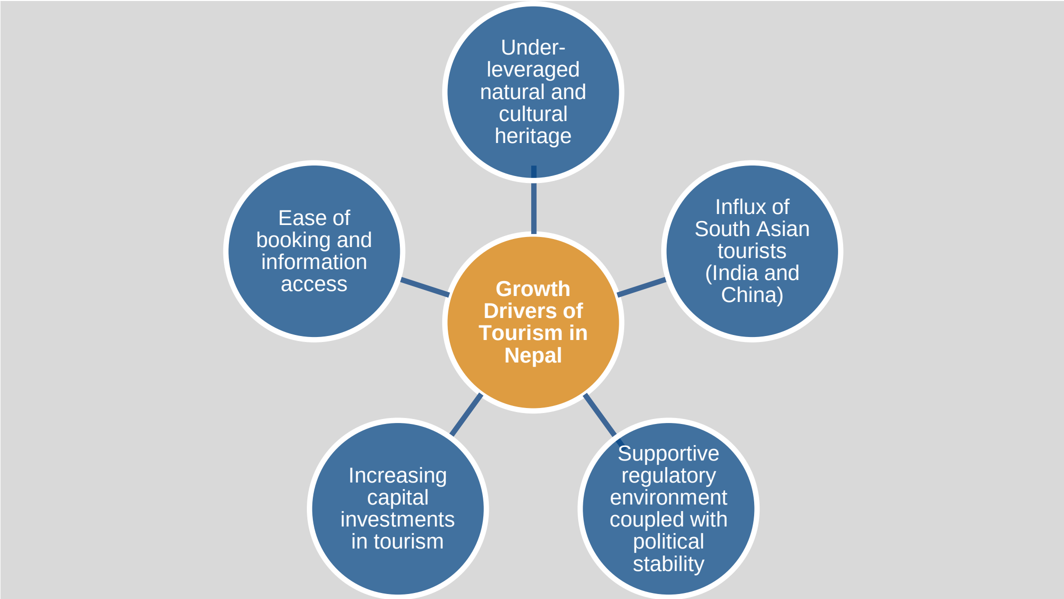
[109] See Section 2.2.1 for details
[110] Calculated based on data reported by MoCTCA in Tourism Statistics 2012
[111] See Section 11.2 for detailed methodology
[112] Intellecap analysis, 2014
[113] See Section 3.5 for details
[114] Government of Nepal, Ministry of Tourism website, accessed in May 2014
[115] Triangulated based on industry estimates shared in primary research and Intellecap analysis, 2014

and grow to comprise 21 to 25% of all tourists[116] over the next few years. In such a scenario, a high growth rate at 13% or greater CAGR may be expected in medium to long term[117].

3.4 Growth Drivers of Tourism in Nepal

The key growth drivers of tourism sector businesses are shown in Figure 20.

Figure 20: Key growth drivers of tourism in Nepal



Source: Intellecap analysis, 2014

Nepal's inherent natural and cultural heritage still remains under-leveraged; and increased use of this heritage to design and promote tourism services can be a major growth driver for the industry

With its rich natural beauty and cultural diversity, Nepal has potential to serve demands for different types of tourism including leisure, wildlife, adventure, rural, and cultural tourism. The favourable climactic conditions; especially in peak season of October and November is also facilitative to growth of tourism. Since the international demand for off-beat and exotic locations growing[118]; these inherent strengths but under-leveraged strengths can be used by the tourism industry in Nepal to position the country as an exciting tourist destination.

Growing influx of South Asian tourists; especially from India and China is driving growth in tourism

The country has seen a steady increase in inbound tourism; especially from India and China. In 2012, Indian tourism arrivals increased at a CAGR of 21% over past 3 years to reach 165815. In the same year Chinese tourism arrivals figured 71861, up 20% y-o-y over the past 5 years[119].

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[116] See Section 3.5 for details
[117] Intellecap analysis, 2014
[118] Euromonitor International
[119] Government of Nepal; Nepal Tourism Statistics, 2012

This growth is driven in-part by the geographic proximity and ease of immigration processes in traveling from India and China to Nepal. This makes it a convenient and comparatively cheaper “foreign-travel” destination for tourists from both countries. India especially is a key driver since not only do Indian citizen travel to Nepal; but many foreign travellers first arrive in India and then travel to Nepal due to lack of air connectivity between Nepal and large parts of the Western hemisphere. Aside from the air-travel network; road and train travel between India and Nepal is also being developed. For an instance, IRCTC has launched a train from the South Indian city Chennai; which traverses through major Indian locations before entering Nepal, and provides connections to Kathmandu, Manakamana, Pokhara and Kushinagar.

Early indications of a supportive regulatory environment coupled with political stability have driven an uptick in inbound tourism

MoCTCA, has undertaken a number of progressive initiatives to harness the potential of tourism in Nepal; such as the “Nepal Tourism Year 2011” campaign which focused on outreach to international markets as well as improvements in domestic infrastructure, and resulted in a year-on-year growth of 22% in inbound tourism. The government also received private sector support from the hospitality, travel and airline industries which also supported the scheme through various incentives. A similar large-scale campaign is planned in 2014[120]; and the “Naturally Nepal: Once is Not Enough” campaign has been ongoing since 2005.

Aside from a direct role in tourism promotion, the government has also taken some steps to build an enabling regulatory environment for the private sector to grow. Foreign Direct Investment (FDI) is allowed in all construction development projects including construction of hotels and resorts, recreational facilities and city and regional level infrastructure. A few specific subsidies and incentives are also available to private sector firms as described in Section 4.3; but these could be improved and made more strategic in nature. The government has also tied up with foreign airline companies to improve its air connectivity and safety infrastructure.

In addition to the positive regulatory measures, the relative political stability and peace in the country over the past few years has also supported growth of tourism.

Capital investment in tourism is gradually increasing, and will catalyse the development of better infrastructure for tourism

Nepal attracted capital investment of US$ 150 million in 2013 in the travel and tourism sector; and this is expected to increase by 2.7% in 2014[121]. MoCTCA is executing several strategic infrastructure projects for upgrading airports, improving heritage sites, building community participation in tourism sector, and investing in capacity building and project management skills. Alongwith the government, several multilateral and donor organisations are also driving capital investments to improve the state of tourism sector in Nepal. The Asian Development Bank and OPEC Fund for International Development (OFID) have jointly committed US$ 46.5 million to a Nepal Government Fund set up for this purpose.[122]

Aside from public sector interventions; private sector activity in improving state of tourism infrastructure is also gathering momentum. For instance, Zonta Club Kathmandu has entered into a partnership with Sulabh Sauchalaya in April 2014 to construct toilet facilities in and around various temple premises.

[120] From primary research done with MoCTCA Nepal, see Annexure for details of interviewees
[121] MoCTCA Nepal
[122] MoCTCA, Nepal; Nepal Tourism News, May 2013

The tourism sector in Nepal may also benefit from exploring Public Private Partnership (PPP) models in building tourism infrastructure. For instance, the Indian government frequently enters into PPP agreements based on "Build, Operate, and Transfer" principle; where the government makes subsidised land available to private sector players in order to incentivise development of hotels, conference facilities, airports and other essential tourism infrastructure. Such projects entail a revenue sharing agreement, and the project remains under private management for a period of 10 to 30 years, after which complete ownership transfers back to the government.

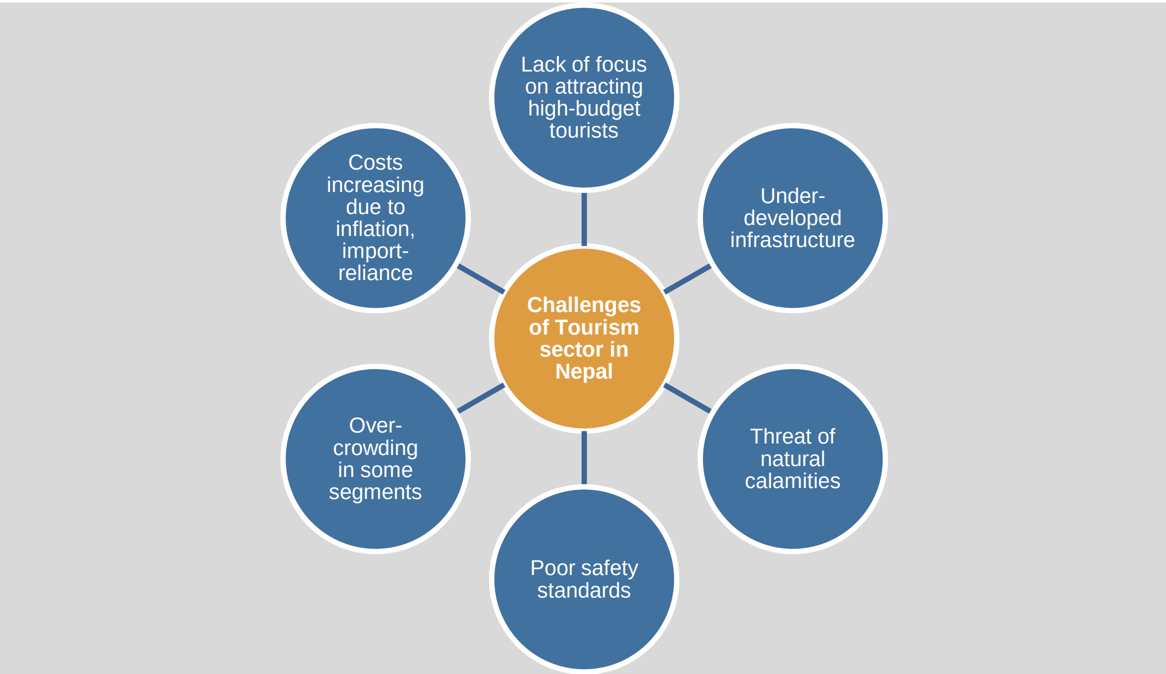
Growing ease of booking and information access through websites and apps is also bringing tourists closer to the industry in Nepal

The travel industry has witnessed a high degree of "democratisation" globally; with real-time booking and information through websites and apps. This has allowed tourists to select the best service providers at optimal prices for their bookings; and also brought tourisms and service providers closer to each other. Most such websites and apps also provide a plethora of information about tourism in Nepal, including popular destinations and advice for tourists. This has "opened up" the tourism market in Nepal and is driving its growth.

3.5 Challenges Facing the Tourism Sector

The sector faces some major challenges as it seeks to scale and address the demand for tourism as shown in Figure 21.

Figure 21: Challenges of tourism sector in Nepal



Source: Intellecap analysis, 2014

The sector has an overall lack of focus on attracting high-budget tourists who are the key drivers of luxury hotels and resorts segment

The tourism sector in Nepal suffers from the disadvantage of being perceived as a "destination for low to mid budget tourists". Such a perception can decrease the number of high-budget tourists traveling to Nepal and hence create a negative impact on the luxury hotels and resorts sector. This poor brand perception is largely driven by the limited public and private focus on attracting niche market of high budget travellers. As a result, most of the current industry players are focused on competing for market share in the low-budget segment. There is intense competition resulting in low priced tour packages with thin margins which need volumes to see any significant profit. Not only does this have a negative impact on revenues, but the influx of tourists is also making popular destinations overcrowded. There may be a long term detrimental impact on the environment as well. Hence, the sector may benefit from also developing strategies to attract high-budget tourists. For instance, Nepal can pick up some best practices from Bhutan, another mountainous South Asian country that has been successful in attracting high-budget tourists as described in Case 1.

Case 1: Bhutan's Success Story

Bhutan's approach to generate high value tourism
Bhutan, a country with same topography as Nepal, has successfully doubled its tourist earnings in the past 3 years Bhutan is a kingdom country in the Himalayas which has the same topography as that of Nepal. In 2009, 23,480 international tourists visited Bhutan for the purpose of holidaying leading to gross earnings of US$ 31.88 million. However, in 2012, the number of international tourists[123] rose to 43,931 leading to a 2x growth in gross earnings which rose to US$ 62.8 million. **Minimum package is required for international tourists to visit Bhutan** To promote "High Value Low Impact" tourism in the country, the Tourism Council of Bhutan requires international visitors pay a minimum daily fee[124] of US$ 200 which includes a royalty fee of US$ 65, accommodation at a 3 star hotel, all meals, a licensed guide, internal transportation, camping equipment, and taxes. This package can be upgraded as per tourist requirements. By using a minimum package requirement, Bhutan is able to secure minimum revenue per tourist which makes a sizable contribution to GDP and increases the public pool of capital available for infrastructure development in tourism. **Bhutan government also focuses on promotional schemes to attract customers in lean season** The Bhutan government launched a campaign called "Bhutan-Thailand Friendship Offer[125]" for summer months of 2014 providing special discounted schemes on the mandatory package, airlines and hotels to attract Thai tourists. This has benefited local businessman to generate business during off-peak months as well rather than depending on particular seasons for tourists; and also results in staggering tourist arrivals to decrease the environmental burden.

Source: Tourism Council of Bhutan website, accessed in May 2014

Poor state of infrastructure and destination management is creating challenges for long term sustainable growth of tourism in Nepal

Tourism infrastructure in Nepal is under-developed; especially in terms of air connectivity between major international destinations and Kathmandu.

[123] International tourists exclude tourists from India, Bangladesh and Maldives as they do not require visa and do not need to pay minimum tariff.
[124] Tourism council of Bhutan; Official Website: Travel requirements
[125] Tourism council of Bhutan; Official Website: Bhutan Thailand Friendship Offer

The country has only one international airport – the Tribhuvan International Airport – which caters to more than 80% of the tourists entering Nepal by air[126]. Efforts to expand the airport´s infrastructure have not been successful in meeting demand which has been witnessing high growth in the past ten years. There is only one runway to handle both domestic and international flights, which currently handles more than two times the air traffic it was handling in 2000 with no major infrastructural improvements. This has led to saturated periods during which no new flights can be added but there is an unmet demand for flights. As a result of the state of air infrastructure, the country has a poor track record of air safety with 3 prominent air crashes reported in the past 5 years[127]. Driven by the poor state of air travel safety, the European Union has banned all airlines from Nepal to fly into its 28 member nations from December 2013 onwards.

Aside from air connectivity for international arrivals; in-country air and road connectivity is poor as well which can act as a deterrent to high-budget travellers. The government is taking steps to rectify these inadequacies, and in February 2014, it signed a MoU with China to establish new flight routes, bring in latest air safety technology and processes to improve the state of air travel infrastructure.

Further, there are very few regulatory guidelines and compliance checks around "destination management" which has led to overcrowding, waste management concerns, and rapid deterioration of existing infrastructure in popular tourist destinations.

Nepal's terrain places it at high risk of natural calamities; and the country has little equipment and technology to predict these and also lacks an emergency medical system for responding to these

Nepal is at significant risk of earthquakes, especially in the Kathmandu valley area which is located over a major fault line that could cause earthquakes ranging up to 8 and above on the Richter scale[128]. An earthquake of this intensity could kill over 100,000 and injure another 300,000 in a single instance. Aside from the Kathmandu Valley, the Himalayan peaks and glaciers also present threat of natural calamities like severe weather conditions and avalanches. These risks threaten not only the domestic population, but can also cause serious injuries or even death amongst tourists. The challenge of natural calamities is further heightened by poor infrastructure to predict these and manage the aftermath. The sector may benefit from joint public-private programs to address this challenge; which left unchecked could harm the image of Nepal as a tourist destination in the event of a large-scale calamity.

Overcrowding and intense competition among small players leads to less profitability in some segments like budget hotels and travel agencies

Nepal's tourism industry is currently concentrated around few locations where there are a number of small players competing against one another especially in the budget hotels and travel agencies segment. This has created intense competition where players are reducing prices to attract more customers leading to fall in quality of services as well as reduced tourism earnings for the country. The government could explore incentivising consolidation or geographic diversification to address this challenge.

Despite these challenges, the overall outlook for the sector remains positive since the government has some progressive measures to address these

126 MoCTCA Nepal

127 Flight Safety Foundation; Aviation Safety Network

128 United Nations Office for the Coordination of Humanitarian Affairs, Preparing for an Earthquake in Kathmandu Valley, 2013

The Nepal government has been focused on improving tourism infrastructure through international branding campaigns, focusing on theme-based tourism, and investing in tourism infrastructure. Several international brand campaigns have been launched including “Visit Nepal Year 2011” and “Visit Lumbini Year 2012”. In 2013, MoCTCA along with other bodies celebrated 60th anniversary of its first ascent of Mt Everest and organised events to promote mountain tourism.

The government has further plans to highlight the Nepalese art, culture, and bio-diversity and stakeholder business internationally through e-marketing. As Nepal is emerging as a prime destination for cultural tourism, the MoCTCA has accorded top priority for development of theme-based tourism like religious and eco-tourism. There are plans to set up cable cars in various religious sites to promote tourism and boost the local economy.

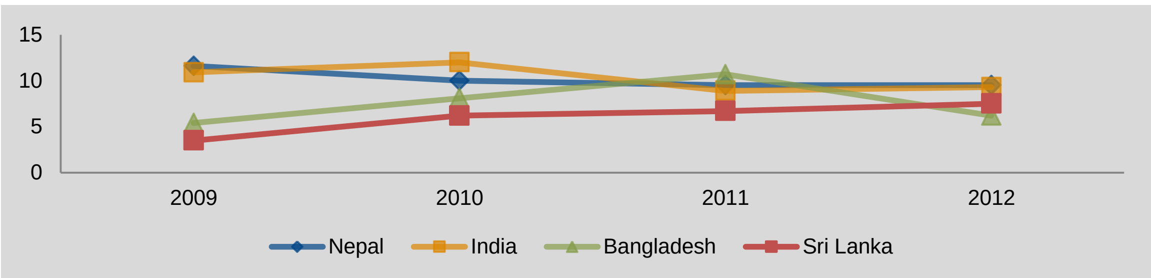
At the infrastructure-level; the Tribhuvan International Airport is undergoing first phase of upgrades that will reportedly halve the growing traffic pressure. The Government has also initiated call for tenders to build a new Gautam Buddha International Airport in Bhairahawa, Lumbini[129]. Industry practitioners interviewed during the course of this study reported that this US$ 3 billion airport is backed by the Chinese Government and is inspired by the air travel infrastructure that supports pilgrimages to Mecca. Aside from Lumbini, the process for development of international airports in Bara and Pokhara has also been initiated[130].

When viewed together, these different trends illustrate the government’s focus on supporting the tourism industry; and hence the overall outlook for tourism sector in Nepal is positive[131].

The prices of tourist services in Nepal are rising at a high rate due to inflation and import-reliance

Nepal reported an inflation rate of 9.72% in January 2014, and both the current rate of inflation as well as historic trends compare unfavourably to other SAARC countries as shown in Figure 22. As a result, prices of essential services, food and fuel are rising at a very high rate in Nepal. This challenge is further exacerbated in the tourism sector by the high degree of import-reliance especially amongst hotels and resorts which rely on suppliers in India and China for interiors, fixtures and kitchen machinery[132]. Hence, the price of tourism service in Nepal has been rising rapidly, and the sector faces the risk of losing potential customers to other South East Asian countries which may be able to provide comparable experiences at more compelling prices.

Figure 22: Comparison of inflation rate (%) in Nepal with selected SAARC countries



Source: World Bank Development Indicators database, accessed in March 2014

[129] MoCTCA tender issued in January 2014
[130] MoCTCA representatives quoted in media reports
[131] Ministry of Culture, Tourism and Civil Aviation, Nepal; Nepal Tourism News; May 2013
[132] From primary interviews conducted during the course of this study in May 2014

4. Regulatory and Policy Landscape in Tourism in Nepal

The Ministry of Culture Tourism and Civil Aviation (MoCTCA) is responsible for formulating and implementing tourism policy

MoCTCA was established in 1978 with a number of roles and responsibilities outlined in 1978 Tourism Act. Its portfolio was broadened with addition of civil aviation affairs in 1982 and cultural affairs in 2000. Present day MoCTCA is involved in monitoring compliance, classifying hotels and other tourist businesses and sanctioning action against non-compliance through, for example, suspending standard classification and cancellation of licences.

MoTCA also has oversight of the Civil Aviation Authority of Nepal (CAAN), the Nepal Tourism Board (NTB), NATHM (the apex body for human resource development) and Nepal Airlines Corporation (NAC – the national flag carrier).

Tourism services in Nepal are governed by the statutory instruments shown in Table 2.

Table 2: Statutory instrument governing Nepal tourism services

Policies	Civil Aviation Policy, 2006; Tourism Policy, 2008
Acts	Civil Aviation Act, 1958 ; Nepal Airlines Corporation Act, 1962; Tourism Act, 1978 amended in 1997; Airport Operation Regulation 1981; Aviation Safety Regulation, 1989; Immigration Act, 1992; Civil Aviation Regulation, 1995; Nepal Tourism Board Act, 1997; Civil Aviation Authority of Nepal Act, 1996; Nepal Tourist Board Regulation, 1998; Industrial Entertainments Act, 1992, amended in 1997; Foreign Investment and Technology Transfer Act, 1992; National Parks Act, 1973, amended in 1994
Directives and Working Procedures	Internal Procedural Directive, 2008; Home Stay Working Procedure, 2010
Rules/Regulations	Trekking and Rafting Rules, 1985; Hotel, Lodges, Restaurants, Bar and Tourist Guide Rules, 1981; Travel and Trekking Agency Rules, 1980; Mountaineering Rules, 1979; Mountaineering Expedition Regulation, 2002; Immigration Regulation, 1994; Rafting Regulation, 2006; Travel and Trekking Agency Regulation, 2005

Ministry of Culture, Tourism and Civil Aviation, Nepal Government

MoCTCA is due to bring out a new 10-year National Tourism Strategy Plan and a 5-year Action Plan to act as a guiding framework for the tourism sector

This strategy is being developed in partnership with SNV and UNWTO; and its overall vision to identify a roadmap for the tourism sector to act as an economic catalyst in Nepal by creating jobs, bringing in foreign exchange, and having spill-over effects on other sectors. The framework is expected to bring in several forward-looking policies for the private sector, especially in improving the business and investment environment, tourism infrastructure and public-private collaboration in marketing and branding initiatives.

The strategy is expected to be rolled out in phases; with the first phase focusing on “diversification and improvement” from 2014 to 2018. The next phase is expected to last for 5 years and will focus on “consolidation and expansion”[133].

[133] UNWTO, Technical Cooperation and Services, National Tourism Strategy Plan for Nepal, 2014

MoCTCA is also ushering in a regulatory framework for adventure tourism which is expected to address several systemic challenges and encourage private sector growth

As a result of increasing government focus on adventure tourism, MoCTCA has presented a new regulation to scrutinise the increasing number of unregulated firms opening adventure tourism in Nepal. The regulation requires compulsory registration of all the adventure sports including rafting, canyoning, caving, bungee jumping, flying, rock climbing, mountaineering and cable car; and proposes legal penalties for firms that fail to comply[134].

These measures are expected to increase safety and security, and bring in a measure of organised activity in the adventure tourism segment which is an important contributor of long-stay, high-budget tourists.

One of the more progressive policies in this sector govern earthquake proofing of hotels and restaurants in Nepal; which is critical given the high risk[135] of seismic activity

The regulatory regime in Nepal requires existing hotels to upgrade to earthquake proof infrastructure, and for new and upcoming hotels to incorporate these features in their building designs[136]. This is a progressive policy in keeping global best practices.

4.1 Licensing Requirements in Tourism

80 to 90% of the licenses needed by tourism sector companies constitute common licenses needed by all private industries in Nepal; travel agencies and tour operators require 3 special licenses and hotels and restaurants require 1 special license

Due to the nascent nature of Nepal's tourism regulatory system, private tourism companies need only a few special licenses in addition to those required by any private company as shown in Table 3. The cost of procuring a license ranges from 10 cents (US$) for VAT registration to over US$ 2000 for incorporation of a business; and the validity ranges from a year until the license holding entity ceases to exist. Different licenses need to be procured from different ministries and departments, taking from 1 day to over a year in processing time.

In addition to these generic licenses, travel agencies and tour operators need 3 special licenses to operate travel agency, trekking agency and guides. Procuring these licenses can take up to 2 days costing around US$ 1 for guide and US$ 150 each for travel and trekking agencies. On the other hand, hotels and restaurants need only 1 additional license to operate their hotels, lodges and restaurants and procuring this license can take up to 15 days. The license fee for hotels varies from US$ 4 to 50 depending on their type with a validity of 5 years.

[134] Travel News Digest; Nepal Tourism announces new regulations and adventure tourism ;2014
[135] National Society for Earthquake Technology-Nepal website, accessed in May 2014
[136] Ministry of physical planning and works, Nepal National Building Code, 1994

Table 3: Licenses needed by tourism companies

Sub-sector/ Licenses	Hotels and Restaurants	Supporting and auxiliary transport activities	Travel agencies and tour operators
1. License to operate Hotels/Lodge/Restaurants	✓		
2. License to operate Rafting Agency		✓	
3. License for Private/Tour/Trekking/River Guide			✓
4. License to operate Travel Agency			✓
5. License to operate Trekking Agency			✓
6. Agency Registration	✓	✓	✓
7. Company Registration	✓	✓	✓
8. Cottage & Small Industry Registration	✓	✓	✓
9. Design Registration	✓	✓	✓
10. Industry Registration	✓	✓	✓
11. Partnership Firm Registration	✓	✓	✓
12. Patent Registration	✓	✓	✓
13. Permanent Account Number (PAN) Registration	✓	✓	✓
14. Permission for Foreign Investment & Technology Transfer	✓	✓	✓
15. Registration of cooperatives	✓	✓	✓
16. Registration of institutions	✓	✓	✓
17. Trademark Registration	✓	✓	✓
18. Value Added Tax (VAT) Registration	✓	✓	✓

Source: Nepal Business License e-portal

4.2 Taxation, Royalties and Subsidies framework in Tourism

The tourism industry in Nepal has very few tax and subsidy incentives, and given the poor state of current infrastructure, this can discourage entrepreneurs from entering this segment

Nepal currently does not offer significant regulatory incentives for private sector to enter tourism market. Other developing countries often have specific incentives for private tourism companies such as tax breaks for a certain period of time, subsidised land, and relaxation on import duties. For instance in India, the government provides free or highly subsidised land for 10-30 years to tourism sector entrepreneurs to set-up facilities like hotels and airports in underserved tourist locations. Entrepreneurs enter into a “Build-Operate-Transfer” agreement with the governments and can operate a tourism-sector business on the subsidised land, keeping a lucrative share of the earnings from the property[137] for a specific time period. Regulatory regime in Nepal could consider bringing in

[137] RBI website; Public-Private Partnership in Indian Infrastructure Development

similar strategic incentives that support the growth of tourism companies to develop tourism infrastructure in under-developed areas.

Tourist hotels, restaurants and travel agencies follow a standard corporate tax structure as described in Table 4, and pay a statutory corporate income tax of 25% in addition to other taxes and duties.

Table 4: Taxation structure for tourism business in Nepal

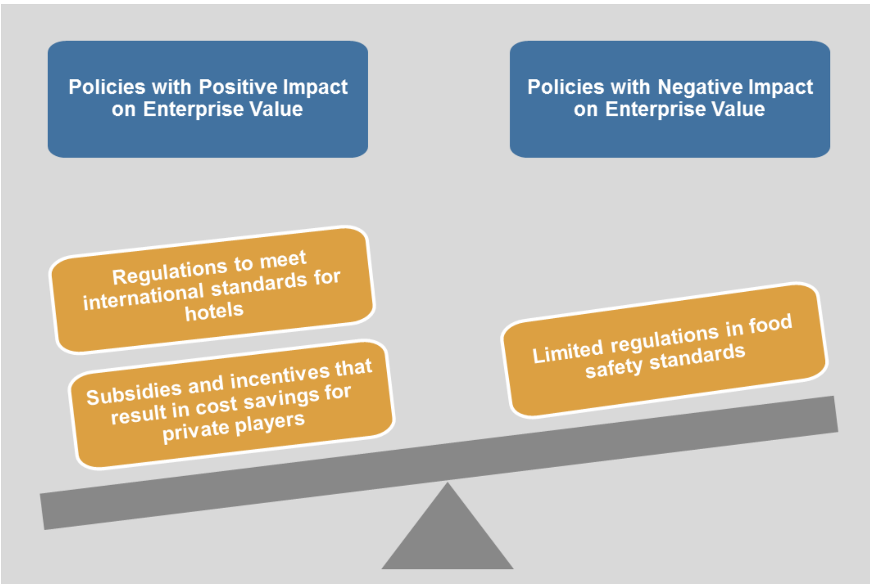
Element	Statutory Tax Rate	Comments
Corporate income tax	25%	Percentage of taxable profit
Employer – paid social security contributions	10%	Percentage of gross salaries
Taxes on vehicles	~ US$ 260	Fixed rate
Municipal business tax	~ US$ 100	Fixed rate
Tax on interest	15%	Percentage of interest income
Property tax	Various rates	Depends on land value
Capital gains tax	20%	Percentage of capital gains
Stamp duty on financial contracts	Various rates	

Source: World Bank, Doing Business Report, 2013; and Inland Revenue Department, Nepal, 2014

4.3 Impact of Regulations on Enterprise Operations and Value

The regulatory regime in Nepal has some degree of positive impact on enterprise value and operations; but this could be enhanced by bringing in more facilitative policies to encourage private sector entry in tourism industry. In addition to tax structure covered in Section 4.2, this impact is also a function of additional rules and regulations as shown in Figure 23.

Figure 23: Impact of regulations on enterprise operations and value



Source: Intellecap analysis, 2014

Operations of hotels and resorts are positively impacted by - (a) government regulations to meet international standards in facilities and (b) a few subsidies and incentives that result in cost savings for private players

Nepal government has recently amended hotel regulations to meet international standards

Until 2013, hotels and resorts in Nepal were under the purview of Hotel, Lodge, Restaurant, Bar and Tourist Guide Regulation 1981. Due to its dated nature, this framework did not include many new international best practices that have been adopted by the tourism industry around the world. In order to do away with this challenge, MoCTCA has issued a new regulatory framework to replace the 1981 guidelines. The new framework is has brought in revisions in categorisation of accommodation providers, necessitates disability-friendly infrastructure, and dictates global benchmarks for infrastructure and service.

The regulations for luxury hotels and resorts are especially progressive and include detailed guidelines around room sizes, types of rooms, and the facilities within rooms among others. These measures will create positive impact by bringing hotels and resorts up to global standards and may serve to attract greater number of tourists which would ultimately drive up enterprise value. This will positively impact Nepal tourism in long term by making hotels in Nepal compatible with current tourism environment[138].

A few subsidies and benefits are available to tourism companies that serve to reduce costs of operations

The few subsidies and benefits that tourism related companies enjoy are listed in Table 5. In addition to these, the government could consider bringing in subsidies that influence and incentivise private sector players to fill need gaps in the tourism market. This would help to decrease the number of undifferentiated tourism companies in crowded markets like Kathmandu and Pokhara; and instead redirect entrepreneurial activity to under-developed tourist locations.

Table 5: Subsidies and incentives available to tourism industry in Nepal

S.No	Subsidy or Incentive
1	10% tax rebate to Tourism companies listed with Security Exchange Board
2	Rebate of 50 % custom duty on the import of luxury coach, micro bus and mini bus is allowed for travel agents, trekking agencies, rafting agencies, hotels and resorts on the recommendation of MoCTCA.
3	Import subsidies on equipment, furniture, and cutlery in year 1 of set up of hotels and resorts
4	Mandatory provision has been made for the employees of profitable public corporations and those employees working in 'A' and 'B' class bank and financial institution to be sponsored for internal tourism trips in Nepal by their respective employers. This may serve to drive up volumes of domestic tourism in Nepal.

Source: Crowe Horwath; Overview of Nepal Financial Budget; 2014, and primary interviews carried out during the course of this study in May 2014

[138] MoCTCA circular (published in Nepal Gazette in October 2013)

Operations and value of hotels and restaurants are negatively impacted by– (a) limited regulations in food safety standards for tourism services

Due to limited regulations in food safety standards; there is no dependable certification of food quality amongst hotels, resorts and F&B retailers which could create a negative impact on tourism

The regulatory regime in food safety standards for hotels, resorts and F&B retailers is weak, and this has a trickle-down effect of decreased tourism spending. As a result, there is a degree of apprehension about the quality of food amongst tourists, especially high-budget tourists, which could negatively impact these facilities.

However, the government is working on bringing in initiatives to strengthen regulation and monitoring of food safety standards in collaboration with the International Finance Corporation (IFC). This support being rolled out under a program called the South Asia Enterprise Development Facility which is managed by IFC in partnership with UKaid and the Norwegian Agency for Development Cooperation[139].

5. Foreign Investment Policy and FDI in the Sector

The government recognises the need for growth capital in tourism and is supportive of private sector investments from foreign countries, however has left out some subsectors to safeguard interests of local industry

100% Foreign Direct Investment (FDI) is allowed in most tourism sub-sectors covered in Section 3.1. However, the Foreign Investment and Technology Transfer Act 1992 which guides FDI currently prohibits FDI in rural tourism, local catering services, travel agency, trekking agency, water rafting, pony trekking, horse riding and tourist lodging facilities[140] to foreign investment.

Significant FDI capital has been invested in the tourism sector in Nepal, but the y-o-y inflows do not follow a predictable trend

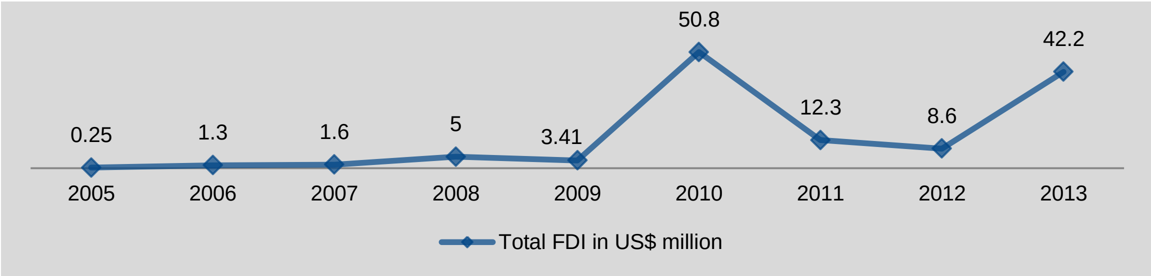
Over US$ 125 million of FDI has been channelled into the tourism sector by foreign entities from over 30 countries from 2005 to 2013 as shown in Figure 24[141]. The top 4 source-countries of FDI capital include China, Hong Kong, British Virgin Islands, and India[142]. Practitioners estimate that outside of promoters' own equity, this is the largest source of private risk capital available in Nepal today[143].

While the FDI inflow has been significant, with tourism accounting for 13% of FDI capital in Nepal[144]; most of this capital is invested in a few large projects. Growth in FDI saw significant upticks in 2010 and 2013, partially due to individual large investments being channelled into the tourism industry. According to reports released by the Department of Industries in Nepal - In 2010, Sarat Industries Ltd. from Hong Kong invested approximately US$ 21 million in Chautarama Pvt. Ltd. (100% stake) for a

139 International Finance Corporation, IFC Helps Improve Food Safety to Boost Tourism in Nepal, 2013
140 Does not include starred-hotels
141 Department of Industries, Industrial Statistics Reports 2005 - 2013
142 Department of Industries, Industrial Statistics Reports 2005 - 2013
143 From primary interviews conducted during the course of this study by Intellecap in February 2014.
144 South Asia Watch on Trade, Economics and Environment (SAWTEE), Foreign Direct Investment in Nepal , 2011

restaurant in Kavre; and in 2013, Global Technology and Trademark Ltd. incorporated in the British Virgin Islands invested approximately US$ 20 million in a subsidiary for a hotel in Bhaktapur[145].

Figure 24: FDI inflows in tourism sector in Nepal

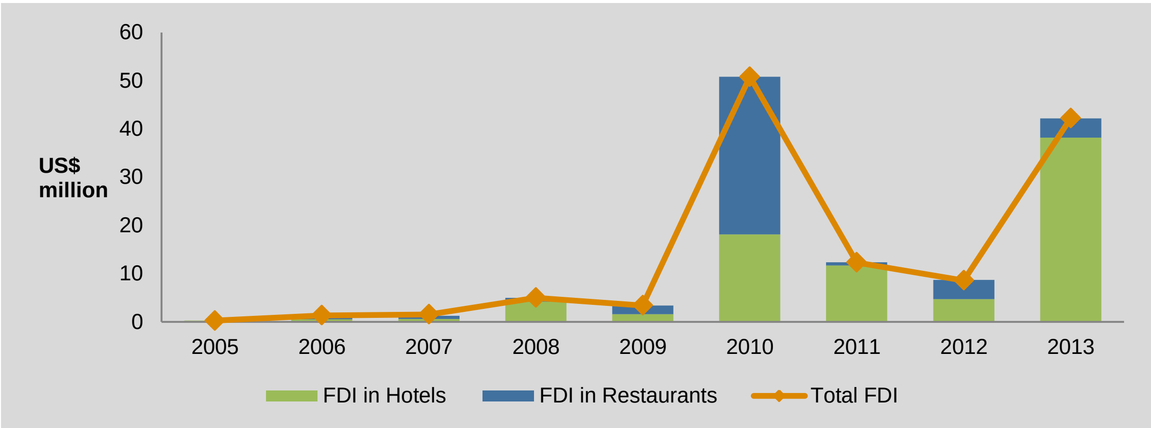


Source: Department of Industries, Industrial Statistics Reports 2005 - 2013

Hotels and restaurants have been key focus sub-sectors for FDI in tourism, cumulatively accounting for 99% of the FDI inflows since 2005

Cumulative capital flows show that foreign companies as well as individuals have made investments primarily in hotels and restaurants; with other businesses like travel agencies, trekking companies and paragliding companies only receiving US$ 0.35 million cumulatively since 2005. Overall, hotels account for 63% of FDI and restaurants account for 36%; although y-o-y splits have been erratic as shown in Figure 25[146].

Figure 25: Breakup of FDI in tourism sector in Nepal



Source: Department of Industries, Industrial Statistics Reports 2005 - 2013

Of the US$ 79.5 million invested in Hotels since 2008, over 40% was channelled from entities incorporated in British Virgin Islands, China, India and Singapore

The flow of FDI in tourism sector has been erratic with highly varying investments from different countries every year, driven by the state of global markets as well as conditions of the local economy from where the FDI originated. China has remained a consistent investor in hotels and it was the largest investor till 2010. British Virgin Islands, India and Singapore were largest contributors to FDI in hotels during 2013, 2012 and 2011 respectively[147].

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[145] Department of Industries, Industrial Statistics Reports 2005 - 2013
[146] Department of Industries, Industrial Statistics Reports 2005 - 2013
[147] Department of Industries, Industrial Statistics Reports 2005 - 2013

Most FDI investments are structured with majority ownership for the foreign investor

Ownership structures in FDI in tourism subsector typically show majority shareholding for foreign investors[148]. Of the 388 FDI deals reported since 2005; 68% were structured as complete buy-out by foreign investor and another 24% were structured as majority stake for foreign investor[149]. One of the major reasons for this trend is the low understanding and acceptance of working with external boards amongst domestic promoters – who prefer to dilute their stake completely rather than enter into a Joint Venture (JV) with a foreign company which requires them to report to a board of directors with external representatives. Another reason is the low availability of exit platforms in Nepal, which forces promoters to take any opportunity they get to realise value from their businesses. Since valuations in Nepal are still on the lower side, often this means that a promoter has to completely dilute stake to get a significant value out of the enterprise[150].

More JVs may come up in the medium term between domestic and foreign entities in the luxury hotel and resort segment

The Nepalese tourism industry is witnessing an emerging trend of foreign entities investing in high-end, luxury hotels and resorts in partnership with domestic players and major international hotel chains. For instance, MIT Group Holding Nepal[151] has signed a contract with Starwood Hotels and Resorts Worldwide to construct a 5-star Sheraton Hotel in Kathmandu. The 225-roomed property with amenities like 4 F&B venues and 16,500 square feet of meeting space is scheduled to be opened in 2018[152]. Similarly, Nepal Hospitality Group has entered into a partnership with Marriott International to open a 4-starred Fairfield by Marriott property in Kathmandu[153].

Encouraging such Joint Ventures (JVs) between domestic and foreign firms in the hotel business can create scale by bringing in both financial support and technical assistance

Aside from financial contribution to firms, foreign firms that form JVs with domestic companies are beneficial in bringing in expertise in the form of technology and processes, management best-practices, and access to markets by virtue of their international brand recognition and centralised sales channels.

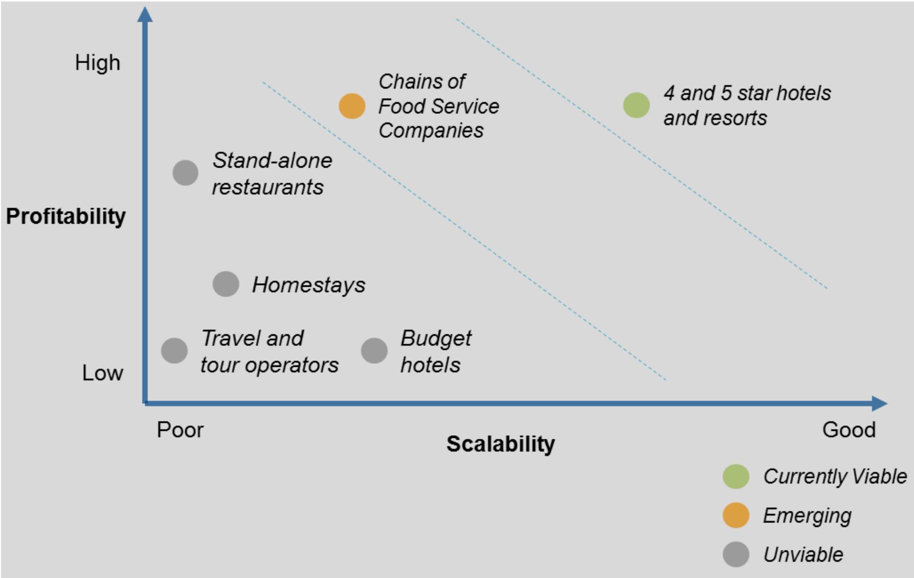
6. Investment Opportunities in Tourism

Investment opportunities for private equity investors in the tourism sector in Nepal can be categorised on the basis of currently viable, emerging and non-opportunities as shown in Figure 26. Two lenses have been considered in categorisation of these opportunities – (a) profitability of typical firms seen in each segment in Nepal; and (b) scalability of firms, which has been determined as a function of firm-level competitiveness[154] and the businesses' ability to take in private equity capital and scale.

[148] Department of Industries, Industrial Statistics Reports 2005 – 2013; and Intellecap analysis 2014
[149] Department of Industries, Industrial Statistics Reports 2005 – 2013; and Intellecap analysis 2014
[150] From primary interviews conducted during the course of this study in May 2014
[151] Promoted by Shesh Ghale, a prominent Non-Resident Nepali
[152] Non-Resident Nepali Association and Centre for Inclusive Growth, Nepal
[153] From primary research conducted during the course of this study in May 2014; also validated by news and media reports
[154] Includes including margins, brand value, use of technology and modern approaches, access to markets and financial health. Competitiveness is also a function of level of external competition that businesses in the sub-sector face; with overcrowded markets being less competitive.

In addition to these, investors may also benefit from being cognisant of high potential tourism sector business models that have been successful in other developing countries of South Asia, but are not currently present in Nepal. Such models are bound to eventually make their way into Nepal by organic and inorganic means; and when they do they could become emerging investment opportunities.

Figure 26: Evaluating comparative attractiveness of investment opportunities in the tourism sector in Nepal



Source: Primary interviews carried out during the course of this study in May 2014, and Intellecap analysis, 2014

Based on the categorisation discussed above, the investment opportunities in the tourism sector in Nepal can be categorised as shown in Figure 27

Figure 27: Categorisation of investment opportunities in the tourism sector in Nepal

Currently Viable Opportunities	Emerging Opportunities with Future Potential	Currently missing but high potential business models	Non-Viable Opportunities
• Luxury hotels and resorts	• Chains of food service companies	• Travel-focused e-commerce • Serviced apartments • Branded mid-budget hotels	• Local travel agencies • Budget hotels • Stand-alone restaurants • Homestays

Source: Intellecap analysis, 2014

Currently viable investment opportunities for private equity investors exit amongst luxury 4 and 5 star hotels and resorts only

Not only is there significant organised and commercial-scale private sector activity in this segment; but high firm-level competitiveness and the ability to take in large sums of private equity capital with preference for minority stake investments can also be seen as discussed in Section 3.2. Moreover this market is far from saturated especially in upcoming tourist destinations outside Kathmandu as discussed in Section 3.1.1.1.

Emerging opportunities can be explored in chains of food service companies

The organised F&B service industry in Nepal is growing rapidly due to the emergence of a new middle class[155] and increasing disposable income[156]. As a result, the demand for food service companies like fine dining and quick service restaurants is steadily rising. Currently, most players on the supply-side are organised as stand-alone entities; but chains of such food service companies can be expected to emerge in the next few years. Early signs of such a trend are already visible, with companies like Himalayan Java and Aangan running multiple outlets with standardised processes and offerings. Given the high margins in F&B business; and the economies of scale that result from operating chains of such businesses; this segment can emerge as a lucrative investment opportunity for private equity players in the near future.

Currently missing but high potential business models include travel-focused e-commerce, serviced apartments, and branded budget hotels

While Nepal currently does not show significant activity in these areas, comparable South and South East Asian countries like India have shown significant business model innovation in these segments to address critical market gaps. For instance, travel-focused e-commerce companies in India have given small and medium tour, hotel and transport operators direct channels for customer acquisition, and have decreased end prices for customers by removing middle-men. Similarly, market gaps like absence of long-stay accommodation options and good quality and affordable hotels have led to emergence of serviced apartments and branded mid-budget hotel chains. Given the success of these models in countries like India, they are bound to find their way to Nepal through organic or inorganic means; and when they would they could emerge as high potential investment opportunities for private equity investors.

Unviable opportunities include local travel and tour operators, stand-alone budget hotels, stand-alone restaurants, and homestays

Typical businesses seen in travel and tour operations, stand-alone budget hotels, stand-alone restaurants and homestays are unlikely to present investment opportunities for private equity investors since they have poor firm level competitiveness and cannot take in large amounts of equity capitals structured as minority stakes as presented in Figure 18.

6.1 Currently-viable investment opportunities

6.1.1 4 and 5-Star Hotels and Resorts

4 and 5-star hotels in Nepal cater to a growing market opportunity presented by the demand from high-value tourists on one hand, and limited supply on the other

There are 40 to 50 high-end 4 and 5-star hotels and resorts in Nepal which cumulatively represent 1500 to 1800 rooms[157]; and have a potential market opportunity of US$ 80 to 100 million[158]. Most are

[155] Asian Development Bank, The Rise of Asia's Middle Class, 2010
[156] See Section 3.1.1.2 for details
[157] Intellecap analysis, 2014 - based on primary interviews conducted during the course of this study in May 2014; MoCTCA Tourism Industry Division, 2013 and Hotel Association Nepal website, accessed in May 2014. Ranges have been used since the number of hotels compiled from different sources showed variation; as did the categorisation of hotels as 4 and 5 star. Further, the MoCTCA does not report on hotel distribution aside from Kathmandu Valley and hence government data is not available.

structured as private limited companies, although 4 are listed[159]. Of these, the 3 listed companies presented in Table 6 are actively traded while Yak and Yeti is not[160].

Table 6: Listed 5-star hotels in Nepal

Company	Category and Location	Number of Rooms	Total paid up value	Market capitalisation
Oriental Hotel Limited	Owns 5-star Radisson Hotel in Kathmandu	160	~ US$ 5 million	~ US$ 37 million
Soaltee Hotel Limited	Owns 5-star Crowne Plaza Hotel in Kathmandu	283	~ US$ 3 million	~ US$ 184 million
Taragaon Regency Hotel	Owns 5-star Hyatt Regency Hotel in Kathmandu	280	~ US$ 17 million	~ US$ 58 million

Source: Nepal Stock Exchange website, accessed in May 2014

The listed 5-star hotels in Nepal report revenues of US$ 7.5 to 12.9 million as shown in Table 7, with median EBIDTA margin of 34%, net profit margin of 14% and ROE of 21%

Table 7: Financial performance of listed 5-star hotels in Nepal

Company	FY 2013 Revenue	EBIDTA Margin	Net Profit Margin	ROE%
Oriental Hotel Limited	US$ 7.5 million	37%	16%	22%
Soaltee Hotel Limited	US$ 12.9 million	27%	14%	21%
Taragaon Regency Hotel	US$ 9.5 million	34%	10%	5%

Source: Calculated from publically available annual reports of Oriental Hotel, Soaltee and Taragaon

The typical cost structure of 4 and 5-star hotels and resorts in Nepal essentially comprises of land, building and machinery, interiors and fittings, F&B supplies, housekeeping supplies, repairs and maintenance, advertising and sales, administration and general expenses, and staff salaries. Of these, the highest contribution to cost structure arises from spend on land, building and machinery, and interiors and fittings.

On the other hand, the key sources of revenue are room rental fee, F&B purchases, MICE and banqueting fee, and other miscellaneous in-hotel purchases. The key metrics that drive revenues in 4 and 5-star hotels and resorts are listed in Table 8, along with the typical trends observed in Nepal.

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158 See Sections 3.3 and 11.2 for details

159 Nepal Stock Exchange website, accessed in May 2014

160 The Yak and Yeti Hotel Company is also currently listed on Nepal Stock Exchange (NEPSE) website but the company shares have not been actively traded since 2002, and in a 2007 general meeting, the shareholders decided to delist the company though clear data on the progress of de-listing is not available. In a 2009 press release, the firm reiterated its decision to de-list and cited a NEPSE regulation – that requires the general public to hold at least 30% shares of a public limited company – as the key reason. The press note stated that the company was not willing to divest shares as it had no need for capital.

Table 8: Key revenue drivers in 4 and 5-star hotels and resorts

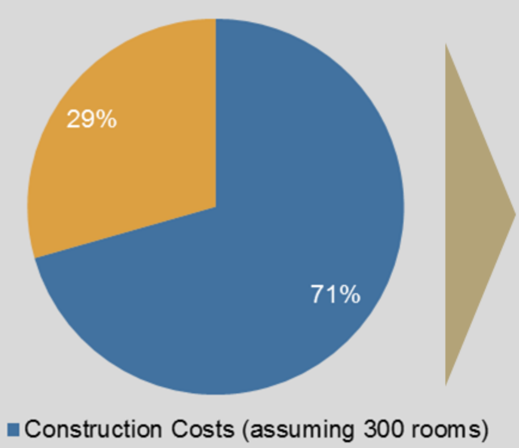
Metric	Trend in Nepal
Number of rooms	~150
Occupancy (%)	~60%
Average room rental	~US$ 150 to 180
Average F&B revenue (as a % of room rental, assuming 2 people per room)	~45 to 50%
Other revenues from MICE, in-hotel purchases (as a % of room rental)	~10 to 15%

Source: Intellecap analysis 2014, based on – primary insights collected during the course of this study in May 2014, MoCTCA Tourism Statistics 2012, and trends from hospitality industry in India

Comparable project cost structure and revenue metrics for a 5-star hotel built in a Tier 2 city in India have been shown in Figure 28

While reliable data on project cost structure and revenue metrics for 4 and 5-star hotels in Nepal was not available; comparable data for a 5-star hotel project built in a Tier-2 city in India is presented here.

Figure 28: Project cost structure and metrics for a 5-star hotel in India



Key cost and revenue metrics for a 5-star hotel built in a tier 2 city in India

Metric	
Construction cost per room (in US$)	150,000 to 200,000
Average Daily Revenue per room (in US$)	250 to 350
Occupancy Rate	70%

Source: Spark Capital Equity Report, 2008

4 and 5-star resorts in Nepal are typically theme-based and have USPs like heritage buildings, casinos or golf courses to attract visitors

Typically 4 and 5-star resorts in Nepal tend to be built over larger land area than hotels; and usually have a theme-based USP to attract customers, such as heritage property, ayurvedic treatments, golf courses etc. While sufficient reliable data distinguishing hotels and resorts was not available, industry practitioners interviewed during the course of this study reported that the top resorts in Nepal by room-size, star-rating and turnover include Gokarna Forest Resort in Kathmandu, and the Fulbari Resort Casino Golf and Spa in Pokhara.

4 and 5-star hotels are largely concentrated in Kathmandu and Pokhara, with no significant presence in other tourist destinations

As presented in Figure 12, most of the 4 and 5-star hotels and resorts in Nepal are concentrated in Kathmandu and Pokhara with no significant presence in other tourist destinations. Given that Nepal has over 550 to 600 other tourist destinations; there is an opportunity for the high-end luxury accommodation segment to also expand to other places[161] - especially in Eastern Nepal which is under-penetrated and offers specific opportunities in tea-based tourism activities and tea-garden themed resorts and hotels.

These hotels primarily operate through three models in Nepal – (a) domestically owned, (b) domestically owned but operated by foreign chain, and (C) JV between domestic and foreign firms

The hotels and resorts that are owned and operated by domestic firms generally have domestic brands - such as Barahi Hotels and Gokarna Forest resort. On the other hand, several large domestic firms, including 3 listed hotel companies in Nepal own their properties but the day-to-day operations are managed by international hotel companies and there is a revenue-sharing agreement involved[162]. Finally, in several upcoming hotel projects such as Sheraton Kathmandu, a JV has been created with co-investments from both domestic and foreign firms.

Key investment opportunities in the 4 and 5-star hotels and resorts category are summarised in Figure 29

Figure 29: Key investment opportunities in 4 and 5-star hotels and resorts in Nepal

Source: Intellecap analysis, 2014

Private equity investors can channel risk capital to support expansion of an existing hotel or resort company by adding to and upgrading infrastructure of an existing property

The 40-50 currently operational 4 and 5-star properties present an opportunity for private equity investors to channel investments into adding rooms and facilities; as well as upgrading existing facilities in order to improve occupancy and revenues. Given that the government is planning a

[161] Nepal Tourism Statistics, 2012; Tripadvisor Nepal; Intellecap analysis, 2014

[162] While data on revenue shares in Nepal was not available, the typical trend in such cases in India is for the foreign firm to take 3% of total revenues and 8% of gross operating profits. Unlike JVs, in these types of management-outsourcing partnerships, the foreign firm takes on low degree of liabilities and the domestic firms remains accountable to shareholders, creditors etc.

tourism campaign similar to "Visit Nepal Year 2011" that can drive up inbound tourism, and that recent regulations to improve hotel standards have been released[163]; the next few years are an opportune time for such investments. In fact, investments in existing and operational properties are likely to have shorter breakeven and exit time frames since the management teams have experience of running the property and the capex (capital expenditure) is lower.

Private equity investors can also support expansion of an existing hotel or resort company which is seeking to build a new property

Given the under-penetrated markets for high end and luxury accommodation outside Kathmandu and Pokhara; private equity investors may also find lucrative investment opportunities in supporting expansion of an existing hotel or resort company which is seeking to build a new property in a new location. Eastern parts of Nepal and popular destinations like Chitwan and Lumbini present good opportunities for such expansion moves[164].

Green-field ventures that seek to start building 4 and 5-star resort and hotels may also be evaluated

In such cases strength of management team and tie-ups with international brands can increase lucrativeness of an opportunity for private equity investors as well as the strategic and operational-readiness for the hotel firm.

Finally, private equity investors may also channel capital towards vertical or horizontal consolidation which can help a tourism-sector firm diversify offerings and improve revenues and profitability

A trend of vertical and horizontal consolidation has been observed in the tourism industry in Nepal[165] where hotel businesses are being started by travel and tour operators that are seeking to diversify their offerings and retain a higher share of the tourists' spending. With investments in their own hotel infrastructure, such travel and tour operators are able to offer end-to-end servicing to tourists at attractive prices while also improving their profitability. Such companies could also provide lucrative investment opportunities for private equity investors.

Key success factors and challenges that investors in 4 and 5-star hotels in Nepal should be cognisant of are summarised in Figure 30.

Figure 30: Key success factors and challenges in 4 and 5-star hotels in Nepal

Key Success Factors	Key Challenges
• Location • Existing land bank for expansion • Diversified customer base • Brand recognition • Managerial strength • Partnerships and linkages with other tourism services firms	• Delay in expansion initiatives • Rising land prices • Low availability of talent • External risks like poor infrastructure and political instability

Source: Intellecap analysis, 2014

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[163] See Section 4.3 for more details
[164] From primary insights garnered during the course of this study in May 2014
[165] See Section 3.1.1.3 for details

Some key success factors that investors can use to evaluate the attractiveness of 4 and 5-star hotels include:

- Right location for a hotel property is a very important success factor: Some salient features of a good location include (a) good view of natural, cultural and other tourist attractions, (b) accessibility from an international airport, and (c) proximity to leisure activities targeted at tourists. At the same time, promoters should display savviness in land acquisition since the high cost of land in prime tourist destinations can impact overall business viability
- Given the high cost of land acquisition in tourist destinations, hotel and resort companies with existing land bank that can be leveraged for expansion may offer more lucrative investment opportunities for private equity investors
- Diversified customer base with healthy split between domestic and foreign tourists is indicative of scalability of a hotel or resort property. Further, diversification in sourcing channels for customers, including B2B and direct online channels is key for long term growth
- Tourism-related customer behavior is driven by “aspirational” and “value for money” sentiments, and hence tourists generally prefer to procure services from well-known and established brands. As a result, brand recognition for hotels is key to growth in this segment – both amongst tourists as well as travel influencers like magazines, blogs and other media. Hotels and resorts that have a tie-up with a foreign hotel chain have a distinct advantage due to higher brand recognition of international hotel chains
- 4-star hotels and resorts are both people-intensive models where the quality of service and staff-interactions with guests are as important as the quality of infrastructure. Such quality is generally driven top-down and hence high quality managerial strength on both strategy and operations-side of a hotel/resort business are critical
- Finally, since tourists are bound to spend a fair degree of their time engaging in tours and activities outside the hotel or resort property, partnerships with high-quality and dependable providers of such services can help hotels and resorts provide end-to-end services to their customers

Some key risks and challenges that investors in 4 and 5-star hotels in Nepal should be cognisant of include:

- Delays in expansion initiatives; especially those contingent upon land acquisition and building construction
- Rising land prices, especially in urban centres like Kathmandu and Pokhara which have a direct impact on project viability
- Low availability of talent, which causes difficulty in hiring and retaining staff
- External risks like poor infrastructure and political instability can have a negative impact on both foreign and domestic tourists

6.2 Emerging investment opportunities

6.2.1 Chains of Food Service Companies

Chains of restaurants and cafés are growing globally, especially in underpenetrated emerging markets in Asia, Africa and Latin America

Chains of restaurant and cafes fall under the ambit of the food service industry, which is in-turn part of the organised F&B industry. The global food service industry is valued at US$ 2.55 trillion with over

6.5 million outlets; and 65% of global spending growth has been observed in emerging markets[166]. The revenues in this market are projected to grow at a CAGR of 5.78% and volumes at CAGR of 5.57% over the next 4-5 years[167]. World-over, the food service industry works in 3 major delivery formats – home delivery; small outlets for take-away with no seating arrangements; and through brick-and-mortar buildings with seating arrangements. This industry runs the gamut from fine-dining to quick service fast-food; and cuisines vary from country to country. In the past decade, a growing middle class in emerging markets of Asia, Africa and Latin America has driven growth of this industry – with local as well as international companies vying for market share.

The demand for fine dining and fast food in Nepal is increasing with rising disposable income and tourist inflow, but the food services industry is fragmented

Disposable incomes in Nepal are rising with growth in per capita Gross National Income[168] as well as remittances[169]. This has resulted in the emergence of a middle class[170] that is shifting consumer demand patterns in the F&B sector towards "out-of-home consumption" like fine dining and fast food. In response to this market demand, over 16,500 micro and small food service companies have come up in Nepal that predominantly operate stand-alone outlets, restaurants and cafes[171]. As a result, this market is highly fragmented and hence currently not lucrative for private equity investors.

Chains of food service companies are in a stronger position to address this demand in a profitable and scalable manner, early traction has been observed

The profitability and firm-level competitiveness of chains of food service companies is greater than stand-alone companies, and hence these chains are better able to address market demand in a scalable manner. Some early traction by chains of food service companies is visible – especially amongst firms like Himalayan Java and Aangan as discussed in Section 3.1.1.2, and this indicates that the domestic market in Nepal is gradually growing.

Similar trends were seen in India in mid-1990s when firms like Specialty Restaurants and Jubilant FoodWorks first launched operations of chains of fine dining and quick service restaurants respectively. By virtue of being early entrants in the organised food services segment, both firms were able to capture market early and are publically listed companies today. For instance, Specialty Restaurants listed in 2012, was oversubscribed 2.5 times and gave its private equity investors[172] Internal Rates of Return (IRR) of 18 and 31%.

While data on operational and financial performance metrics for food service companies is not available in Nepal; data from listed firms in India can be used for comparison

Organised activity in the food services segment in India accounts for 7.24% market share[173], and this is projected to continue growing with rising incomes, rapid urbanisation of smaller towns, and changing demographics. Two specific models that have seen growth in India are chains of fine-dining restaurants and chains of quick service/fast food restaurants. A snapshot comparing key operational and financial metrics of both models is presented in Table 9, using publically reported data from Specialty Restaurants and Jubilant FoodWorks.

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[166] GLG Research / Johnson Cornell University Emerging Markets Institute, Food Service Industry Trends in Emerging Markets, 2012
[167] Infiniti Research Limited, Global Foodservice Market 2014-2018, 2014
[168] World Bank Development Indicators
[169] World Bank Development Indicators
[170] ADB, Asia's New Middle Class, 2012
[171] Concern for Children and Environment – Nepal estimated that on an average, there are 220 restaurants per district in Nepal; in their survey titled "National Survey on Child Labour in Restuarants"
[172] SAIF partners and Glix Securities, as per data from Venture Intelligence
[173] Food Franchising Report, 2009

Table 9: Operational and financial metrics of food services companies in India

Metrics	Fine Dining Chain (Specialty Restaurants)	Quick Service/Fast Food Chain (Jubilant FoodWorks)
Number of outlets	96	602
Geographic focus	Tier I and II cities	20% in Tier I cities, 80% in Tier II and III cities
EBIT Margin	13.65%	13.2%
PAT Margin	10.32%	9.3%
ROE%	14.22%	31%
Brand	Own brand	Franchised brand (Dominos)
Outlet ownership	60% owned, 23% franchisees, also have 14 confectionary outlets	Owned

Source: Company websites and annual reports; Right Horizons Equity Report on Jubilant FoodWorks, 2014;

Growth in chains of food service companies like restaurant and café-chains is expected in the near future; with entry of existing domestic firms, foreign firms and establishment of new firms likely

Given the early traction in Nepal, as well as demonstrated success of chains of food service companies in India, it is likely that this segment will emerge as a lucrative opportunity for private equity investors in the near future. Promoters of such food service companies in Nepal may include existing domestic business groups in allied segments like hotels, first generation entrepreneurs from Nepal, and foreign firms that are seeking to expand to Nepal. Bikanerwala and Gulab sweets are good examples of foreign food service firms that have already expanded in the Nepal market, and an expansion move could also be expected from Jubilant FoodWorks which is the master franchisee for Dominos' pizza in Nepal[174].

6.3 Currently Missing but High Potential Opportunities

6.3.1 Travel-Focused E-Commerce

The tourism accommodation and tours and travels sector is fragmented in Nepal, making it difficult for consumers to reach businesses directly

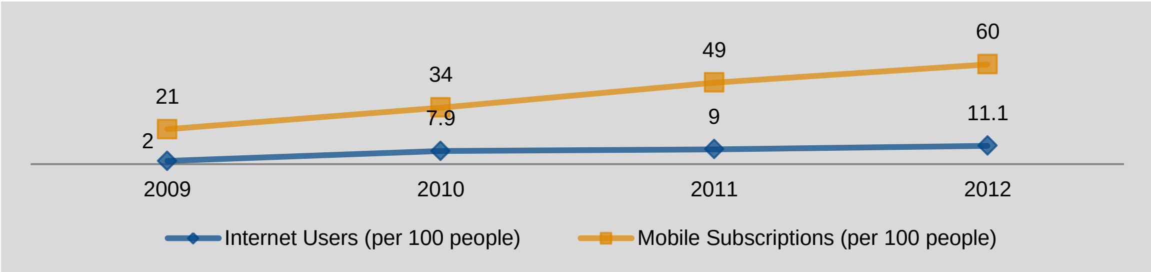
There are over 2100 micro and small tour and travel operators in Nepal, and over small 1600 tourist accommodation providers[175]; leading to a fragmented market with high degree of information asymmetry between buyers and sellers. As a result, tourists have to rely on middle men or travel agents to access services; and tourism-facility providers similarly rely on these middle-men for customer acquisition. This causes higher prices for the former and reduction in profit margins for the latter; and makes for an inefficient market.

[174] Moneycontrol Equity Reports
[175] MoCTCA, Tourist Statistics Nepal, 2012

Travel-focused e-commerce companies could bring buyers and sellers closer, and the improving IT and Telecom infrastructure in Nepal makes it an opportune time for such models to enter the market**

Given the information asymmetry between buyers and sellers in the tourism market in Nepal, there is a need for an easily accessible and scalable marketplace that connects both sides; and this presents an opportunity for travel-focused e-commerce firms to enter the market. The improving IT and telecommunications infrastructure in Nepal as shown in Figure 31 could also play a supporting role for such firms.

Figure 31: Improving internet and mobile penetration in Nepal



Source: World Bank Development Indicators database, accessed in May 2014

Global market in travel-focused e-commerce is growing, and some early activity by international travel e-commerce firms in Nepal has been seen

This segment is growing globally at 8.4%, and is it estimated that 25% of all tourism related purchases (worth US$ 524 billion) are made digitally via e-commerce platforms[176]. While no significant activity has been observed in this segment by domestic firms in Nepal thus far, international travel e-commerce companies like TripAdvisor have started retailing tourism services with a primary focus on foreign tourists. Domestic firms may have an edge over international e-commerce firms by forging close partnerships with tourism facility providers for better rates and discounts, and using local knowledge to help buyers navigate to the best choices of service providers.

India presents a comparable example, where travel-focused ecommerce occupies significant share of digital sales and is showing steady growth

Since there is a lack of domestic activity in travel- focused e-commerce; it is useful to evaluate trends from the neighbouring tourism market in India to understand the potential for travel-focused e-commerce. The Indian travel-focused e-commerce market is worth over US$ 6.44 billion currently, and dominates the e-commerce industry with over 75% of all digital purchases in India comprising purchase of tourism services such as hotel bookings, airline and train tickets, and tour packages[177]. Leading companies in this segment by volume of traffic include makemytrip.com, yatra.com, ibibo.com and cleartrip.com. 80 to 90% of the revenues of these firms come from travel ticketing transactions; followed by hotel booking and tour packages[178]. However, the margins in hotel and tour sales are higher at 10 to 25% than air and train travel which are in the range of 7 to 10%[179]. Given the

[176] World Travel Market, Global Trends, 2013
[177] Internet and Mobile Association of India, and Indian Market Research Bureau International; 2012
[178] Ernst and Young, Rebirth of e-commerce in India, 2012
[179] Avendus, 2012

growing demand for domestic and inbound business and leisure travel in India; travel-focused e-commerce is expected to show steady growth over the next few years[180].

Travel-focused e-commerce firms may emerge in Nepal in the future; likely promoters include large tour and travel operators and IT/ITES firms

Driven by the on-ground market need for bringing buyers and sellers in tourism industry closer; as well as the growing global market in online travel sales; it is expected that travel-focused e-commerce forms may emerge in Nepal in the near future. These are likely to be promoted by large tour and travel operators seeking to diversify operations; as well as by local IT/ITES companies seeking to make a product-play.

6.3.2 Serviced Apartments

Serviced apartments segment is rapidly emerging as an alternate to hotel accommodation for long-stay-travelers and tourists

Serviced apartments are a type of tourist/traveler-accommodation designed for long-stay guests as an alternate to hotel accommodation[181]. They typically tend to be larger than hotel rooms, and often include additional facilities like kitchen appliance and sit-outs. Such apartments typically retail at 25 to 30% lower rates than pure-play hotel rooms[182] and services are often customised for guests[183]. The global market for serviced apartments in developed markets is largely driven by business travelers; though in places of tourist importance with longer average "durations of stay", they also cater to leisure tourists. There are close to 700,000 serviced apartments units globally, which together account for more than 7% market share of temporary accommodation units sold.

There is a market opportunity for high-end serviced apartments in Nepal given low supply of 4 and 5-star hotels and resorts; and comparatively long average durations of stay

The supply-side of luxury accommodation in Nepal is inadequate with only 40-50 4 and 5-star hotels[184]. There are also a handful of serviced apartments (such as Mandala, Retreat, 9 Rooms, and Park Village Apartments) that are specifically targeted at long-stay travelers.

On the demand-side however, Nepal does seem to attract tourists and international travellers that may form an attractive customer segment for high-end serviced apartments. Aside from long-stay leisure travellers, these include business and official travellers who often visit for several months at a time, as well as expatriates who work with international and local businesses and development sector organisations on short term contracts. Since the average duration of tourist stay in Nepal (12.16 days[185]) is much higher than average stay in several South Asian and South East Asian countries as shown in Table 10; this presents an opportunity for the serviced apartment industry to grow in Nepal.

[180] emarketer, 2014
[181] The Apartment Service Worldwide, The Global Serviced Apartments Industry Report, 2013-14
[182] IBEF, Serviced Apartments – Home Away from Home
[183] The Apartment Service Worldwide, The Global Serviced Apartments Industry Report, 2013-14
[184] MoCTCA, Tourism Statistics Nepal, 2013
[185] MoCTCA, Tourism Statistics Nepal, 2013

Table 10: Comparison of average length of stay of tourists

Country	Average Length of Stay of Tourists*
Nepal	12.16
Thailand	9.19
Cambodia	6.5
Bhutan	8.7
Sri Lanka	10

Source: Nepal data from MoCTCA Tourism Statistics Report 2012; other countries from UNCTAD Handbook of Statistics, 2007

** Statistic covers overall length of stay of tourist in a country from time of entry to time of departure.*

India presents a comparable example, where serviced apartment market has been growing rapidly with activity from both domestic and foreign firms

The market for long-stay accommodation in India took off in early 2000s largely due to growing demand from business travelers. Along with Indian operators like Taj Group, and Brigade Group; many international serviced apartment operators like Oakwood, Bridgestreeet, and Ascott; and hotel operators like Hyatt, Marriott, Carlson and Four Seasons have also entered the market. While the concept of serviced apartments took off due to demand from business travelers, the demand from leisure tourists has also seen an upswing over the past few years. The market is estimated to currently service 20 to 30% of the overall demand for accommodation[186]; however given the challenges in defining a "serviced apartment", clear market segmentation is difficult to arrive at. The typical room rentals charged by serviced apartments in the Indian Subcontinent are shown in Table 11.

Table 11: Typical room rentals for serviced apartments in the Indian Subcontinent

Length of Stay	Rental for Studio Apartment (US$)	Rental for 1 Bedroom Apartment (US$)	Rental for 2 Bedroom Apartment (US$)
1 week or more (tariff/per night)	44 to 88	51 to 142	68 to 244
1 month or more (tariff/month)	962 to 1,388	1,101 to 2,165	1,100 to 2,091

Source: The Apartment Service Worldwide, The Global Serviced Apartments Industry Report, 2013-14

[186] The Apartment Service Worldwide, The Global Serviced Apartments Industry Report, 2013-14; and primary research done by Intellecap in May 2014

Organised activity in serviced apartments may emerge in Nepal in near future; likely promoters include existing hotel operators, real estate players and foreign firms

Driven by the on-ground market need for accommodation for long-stay travelers in Nepal, as well as the inadequacy of 4 and 5-star hotel and resort infrastructure, it is expected that serviced apartment segment may emerge in Nepal in the near future. These are likely to be promoted by existing hotel firms seeking to diversify to an "extended-stay segment"; as well as real estate firms focused on the housing and apartments market in Nepal. Foreign firms are also likely to evaluate the opportunity given the recent traction in this segment in the neighboring country of India.

6.3.3 Branded Budget Hotels

The hotels segment in Nepal has a "missing middle" of mid-budget branded hotels

While the number of 4 and 5-star hotels in Nepal that retail at US$ 120 or more per night[187] is in the range of 40-50, and there are thousands of unbranded, stand-alone economy hotels; the market has a missing middle of mid-budget branded hotels that retail at a tariff of US$ 50 to 100 per night[188]. This category is a well-defined segment in many developing countries like India and Indonesia, and differs from 4 and 5-star hotels on one hand, and economy hotels on the other by virtue of having similar standards of service as 4 and 5-star hotels but with fewer amenities like banqueting, spa, multiple restaurants and deluxe room fittings[189] that tend to add overheads to hotel promoters and thereby increase prices for travellers. For instance in India, the cost of construction of a branded mid-budget hotel room is US$ 60,000 to 90,000 and it tends to retail at US$ 40 to 60[190]. On the other hand, the cost of construction of a branded 4 to 5-star hotel room is US$ 150,000 to 200,000 and it tends to retail at US$ 250 to 300[191].

India presents a comparable example, where the mid-budget hotel market has been growing rapidly with activity from both domestic and foreign firms

Mid-budget rooms constitute 29% of total hotel rooms in India[192], and activity by branded hotel chains in this segment has witnessed an upswing in the past 5 to 7 years. Several established domestic and foreign hotel operators have entered this segment as shown in Table 12. The total number of units of such hotel rooms is set to witness a significant increase over the next few years as over 50 to 60% of the construction-stage rooms supply is estimated to belong to this category[193]. This market has seen a specific impetus on growth in Tier II and III cities, for both business and leisure travelers.

Table 12: Selected mid-budget branded hotels in India

Brand	Promoter Company	Number of Hotels	Geographic Focus	Typical Tariff
Ginger	Indian Hotels Company (also own the Taj Hotels)	30 hotels	Primarily Tier I, Tier II and III cities, business and leisure destinations	US$ 30 to 40

[187] From company websites and e-booking portals
[188] From primary interviews conducted during the course of this study in May 2014
[189] HVS Hospitality Reports
[190] HVS Hospitality Reports
[191] Spark Capital Equity Report, 2008
[192] Hotelier India, Citrus Hotels
[193] HVS, Hotels in India - Trends and Opportunities, 2011

Brand	Promoter Company	Number of Hotels	Geographic Focus	Typical Tariff
Holiday Inn Express	JV between InterContinental and Duet Hotels	1 operational hotel, 1 opening soon	Tier II cities, primarily business destinations	US$ 50 to 65
Hometel	Sarovar Hotels and Resorts	6 operational hotels, 1 opening soon	Tier I, II and III cities, primarily business destinations	US$ 45 to 100
Ibis	Accor Hospitality	7 operational hotels, 2 opening soon	Primarily Tier I and II cities, business destinations	US$ 30 to 95
Keys	Berggruen Hotels	6 hotels, 1 serviced apartments and 3 resorts operational, 21 opening soon	Tier I, II and III cities, business and leisure destinations	US$ 35 to 75
Peppermint	Peppermint Hospitality	4 hotels in India	Tier I, II and III cities, primarily leisure destinations	US$ 35 to 50
Redfox	Lemon Tree Hotel Company	4 hotels	Tier I and II cities, primarily business destinations	US$ 40 to 50

Source: Company websites accessed in May 2014

Mid-budget branded hotels may emerge in Nepal in the near future; likely promoters include existing hotel operators, travel and tour operators, and foreign firms

Driven by the on-ground market need for affordable yet high quality accommodation in the range of US$ 50 to 100, and the absence of this segment on the supply-side, it is expected that branded mid-budget hotels may emerge in Nepal in the near future. These are likely to be promoted by existing hotel firms seeking to diversify to a "price and quality conscious" clientele; as well as tour and travel operators seeking to diversify their offerings to their existing clientele.

6.4 Non-Viable Investment Opportunities

Unviable opportunities include local travel and tour operators, stand-alone budget hotels, stand-alone restaurants, and homestays

Typical businesses seen in travel and tour operations, stand-alone budget hotels, stand-alone restaurants and homestays are unlikely to present investment opportunities for private equity investors since they have poor firm level competitiveness and cannot take in large amounts of equity capitals structured as minority stakes as presented in Figure 18.

7. Exit Opportunities for Investors in Tourism

The flow of private equity investments into 4 and 5-star hotels and resorts in Nepal is a comparatively new phenomenon. The few investments made so far have largely involved domestic promoter equity or FDI capital as shown in Section 5. Further, the only recorded exits thus far have been restricted to public listing of firms on NEPSE as presented in Table 6.

As a result, this creates a challenge in predicting exit trends as there is a lack of historical data as well as financial industry infrastructure to facilitate exits.

7.1 Spectrum of Exit Routes

A key role that private equity firms are expected to play in the 4 and 5-star hotels and resorts segment in Nepal is to help businesses expand the infrastructure for serving high value tourists, and thereby attract a greater number of such tourists to Nepal which in-turn has a positive impact on the economy[194].

With these investments; companies that operate 4 and 5-star hotels and resorts are likely to grow faster, increasing their revenues and profitability and thereby increasing firm value. This in-turn results in making such businesses attractive to other investors – ranging from investment funds to foreign hotel chains - that can buy-out stake of first investor at a higher valuation. It is also possible that enough value is created for the promoter or the management team to buy-out investors' stake. A broad overview of the various possibilities in exits are discussed here, followed by a hypothesis on which are likely to be popular exit routes in Nepal.

Generally speaking, the process of an equity investor selling stake to another investor at a higher valuation is termed an "exit", and the spectrum of possible exit opportunities includes – (a) Management / Promoter buyout, (b) Secondary Sale, (c) Trade Sale, (d) Initial Public Offering (IPO)[195].

- **Management / Promoter buyout:** Management / Promoter buyout involves the repurchase of the private equity investors' shares by the company and/or its management. The management buyout method is popular amongst hotel and resort-promoters in Nepal given that profit margins and liquidity are on the higher side. In such situations, promoters may utilise the cash earnings for buying back the stake of private equity investor.
- **Secondary Sale:** Secondary sale is the purchase of the private equity investors' or others' shareholdings by another investment institution. Private equity investment activity in Nepal is still an emerging phenomenon; however development financial intuitions such as IFC have been active in making risk capital investments in Nepal in recent past. Secondary sale would be an attractive method to exit in Nepal once the investment eco-system develops and matures.
- **Trade Sale:** A trade sale involves selling the company's shares to another company (structured as a merger or an acquisition) usually in the same industry sector when the acquirer needs the company to supplement its business areas[196]. The numbers of publicly available Merger and Acquisition (M&A) transactions in Nepal are on the lower side[197], but the activity is picking up in recent years after the political stability in the country. Many companies in Nepal have started to realise the benefits of economies of scale and scope, increased revenue and market share, cost reduction through consolidated operations.

194 See Section 2.1 for details
195 Intellecap primary research
196 A trade sale is similar to 'strategic' sale
197 Excluding Banking, Financial Services and Insurance sector

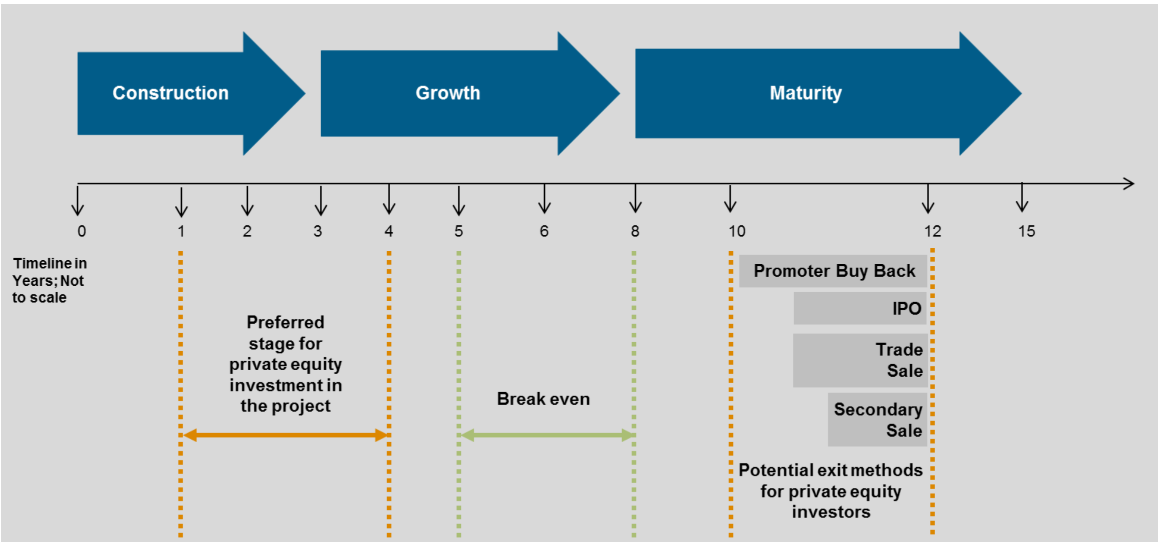
- **IPO:** IPO is used to publicly share the equity offering that is followed by the listing of shares on stock exchange. The capital markets in Nepal are in nascent stage and are dominated by banks and financial institutions where presence of real sector on the capital markets is very low (excluding the hydropower sector)[198]. IPO route could also a potentially popular exit route for investments in the hotel sector, but only in firms where promoters are willing to open up their firms and operations to the level of scrutiny and accountability demand from public limited companies in Nepal

7.2 Likely Exit Routes for Tourism in Nepal

Private equity firms investing in 4 and 5-star hotels and resorts in Nepal may need to stay invested for 8 years or more before finding a lucrative exit

4 and 5-star hotels and resorts in Nepal generally take 5-8 years to breakeven and are expected to have higher trends in profitability thereafter[199]. Private equity investors should be cognisant of the projected break-even in specific opportunities to estimate lucrative entry and exit times. A successful exit will depend on the entry points of investments; which is usually the construction and/or expansion stage for a hotel/resort project. The requirement of capital is highest at this stage and investments can be made at lucrative valuations. Based on insights from industry practitioners and Intellecap analysis, the capital value chain for possible exit options for private equity investors in 4 and 5-star hotels and resorts is shown in Figure 32.

Figure 32: Broad timeline for private equity exits in 4 and 5-star hotels and resorts segment



Source: From primary interviews conducted during the course of this study in May 2014, and Intellecap analysis, 2014

In order to manage risk of investing in an early stage hotel or resort venture, investors can use the non-financial valuation metrics discussed in Section 10.4 to identify high potential opportunities. Additionally, investors may find it less risky to enter at construction stage in more well-established ventures; and just before or in early stage operations of green-field ventures.

[198] Refer Annexure 11.4.1 for detailed discussion in capital markets in Nepal
[199] From primary interviews conducted during the course of this study in May 2014

Promoter buy-back likely to be most popular approach for private equity exits in 4 and 5-star hotels and resorts segment in Nepal

Re-purchase of private investor's shared by promoter(s) is likely to be the more prevalent approach for exits in 4 and 5-star hotels and resorts since the business model enjoys high margins and has a high market opportunity as well. While promoter ability to buy-back will be one driver; the other will probably be the prevailing promoter sentiment where existing promoters want to ultimately retain complete control of the firm. There seems to be a high degree of apprehension about loss of control that could result from diluting management stake[200].

IPO may be observed in a few cases given the successful listing of 3 large 5-star hotel firms

While public listing of firms is still rare in Nepal as a general matter; this could be a likely exit route for private equity investors to exit given that 3 large hotel operators have achieved successful exits and are actively traded as shown in Table 6. These firms reported a median return on equity of 21%[201] in FY 2013, and can be used as blueprints to model potential exits in 4 and 5-star hotels and resorts in Nepal.

Trade sale and secondary sale have lower likelihood in the near future

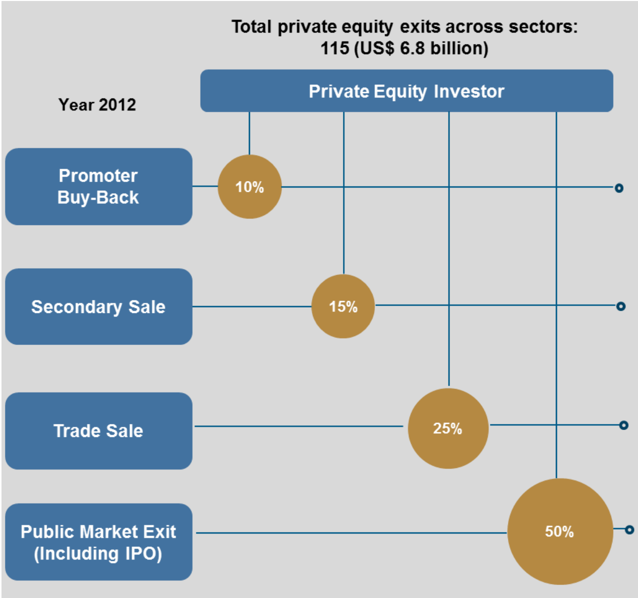
Overall, trade sale and secondary sale show less likelihood in the near future. Trade sales are unlikely given reluctance to acquire existing properties amongst domestic firms on one hand, and the preference for entering early as first investors amongst foreign firms on the other. Secondary-sale is also unlikely since it requires the establishment of a value-chain of equity investors who have differing but complementary investment sizes, risk appetites and preferred stages of investment. Give that the practice of equity investing in Nepal is very nascent, this value-chain will take time to emerge. Most investors are likely to prefer growth-stage investments with lower risk and shorter return timeframes and their investing activity is more likely to be competitive than complementary as was observed in the Indian context 7-8 years back.

7.2.1 Exit Trends Observed in Tourism in India

The capital markets in India are much more developed compared to Nepal[202] and the private equity investing activity is at a more advanced level. The most popular exit route for both venture capital and private equity investments in India is through public market sales, including IPOs. Out of the 115 equity exits reported in India 2012, more than 50% were through public market sales, including IPOs[203]. The trends in exits in India have been shown in Figure 33 below.

[200] From primary interviews conducted by Intellecap during the course of this study in May 2014
[201] From Annual Reports of Soaltee, Taragaon and Oriental published in the public domain
[202] Refer Annexure 9.4.3 for details
[203] IVCA; India Private Equity Report 2013, Bain and Company

Figure 33: Distribution of private equity exits in India

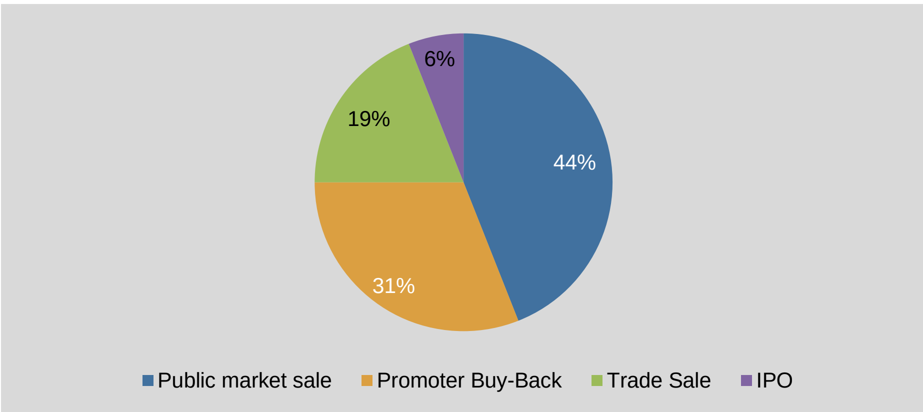


Source: IVCA; India Private Equity Report 2013, Bain and Company

Public market sale and promoter buy-back are popular modes of exits from hotels and resort companies in India

A total of 33 private equity investments cumulatively worth US$ 0.79 billion have been reported in the hotels and resorts segment in India between 2009 and 2014[204]. A total of 16 exits have been observed in the same period; with public market sale and promoter buy-back being the prevalent forms of exit as shown in Figure 34.

Figure 34: Prevalence of different modes of exits in hotels and resorts segment in India (2009-2014)



Source: Venture Intelligence India database

Return multiples across hotel and resorts exits in India typically range from 0.41x to 2x[205]

Specific details of 16 exits observed in hotels and resorts in India between 2009 and 2013 are shown in Table 13.

[204] Until May 2014
[205] Venture Intelligence India database, accessed in April 2014

Table 13: Private equity tourism exits reported in India between 2009 and 2013

Company	Acquirer	Seller	Deal Size (US$ mn)	Exit Status	Exit Procedure	Return Multiple
BW Highway Star	Kamat Hotels	Clearwater Capital	10.85	Complete	Strategic Sale	1.06x
Chalet Hotels	Promoters	IDFC PE		Complete	Buyback	-
Cicada Resorts	Coffee Day Hotels & Resorts	Premji Invest	1.78	Complete	Strategic Sale	0.53x
Daman Hospitality	Delta Corp	Paracor Capital	14	Complete	Strategic Sale	2x
DB Hospitality	Company (DB Hospitality)	Trinity Capital	22.53	Complete	Buyback	1.17x
East India Hotels	-	Elephant Capital	8	Complete	Public Market Sale	0.85x
East India Hotels	-	Elephant Capital	3.12	Partial	Public Market Sale	-
Graviss Hospitality	-	Temasek	7	Partial	Buyback	-
IHHR Hospitality	Promoters	Morgan Stanley		Complete	Buyback	-
Kamat Hotel	-	Clearwater Capital	0.78	Partial	Public Market Sale	0.46x
Mahindra Holidays & Resorts	-	NYLIM Jacob Ballas Funds	58	Partial	IPO	-
Royal Orchid Hotels	-	Sequoia Capital India	2.4	Partial	Public Market Sale	0.41x
Sayaji Hotels	Promoters	Clearwater Capital	11.5	Complete	Buyback	1.76x
Sayaji Hotels	-	Clearwater Capital	2	Partial	Public Market Sale	1.64x
Sayaji Hotels	-	Clearwater Capital	2.4	Partial	Public Market Sale	1.77x
Sayaji Hotels	-	Clearwater Capital	0.45	Partial	Public Market Sale	1.8x

Source: Venture Intelligence India database, accessed in April 2014

7.3 Challenges in Exit

The key challenges to private equity exits in Nepal fall under three broad categories as shown in Table 14; i.e. systemic, equity investor-related and promoter-related challenges.

Table 14: Challenges in exits in Nepal

Systemic Challenges
Nascent industry, so higher risk and longer return horizons are possible
Little or no regulatory oversight for private exit markets

Lack of investor-entrepreneur connection platforms and investment intermediaries
Over-reliance on foreign equity
Currency devaluation risk
Lack of exit platforms designed for secondary-sale
Equity Investor-Related Challenges
Less experience of managing portfolio companies in economies like Nepal
Difficulty in building deal-flow
Lack of risk assessment frameworks customised for Nepal
Hotel/Resort Promoter-Related Challenges
Lack of awareness about the comparative benefits of debt and equity
Apprehensions around working with external boards and fear of losing control of company

Source: Intellecap analysis, 2014

In addition to these, some regulatory hurdles that could be challenges for private equity investors in the hotels and resorts segment are:

Promoter lock-in period of 3 years: This is a key challenge for exits of private equity companies in Nepal. The existing provision and law states that "the shares subscribed by the shareholders in the groups other than public (group of promoter and other) of the body corporate which is eligible for going public, shall not be qualified for sale unless a three years period after the allotment of such shares is complete"[206]. The three years lock in period for private equity investors is on the higher side in the SAARC when compared to one year in India[207] and Sri Lanka[208] and no lock in period in Bangladesh[209].

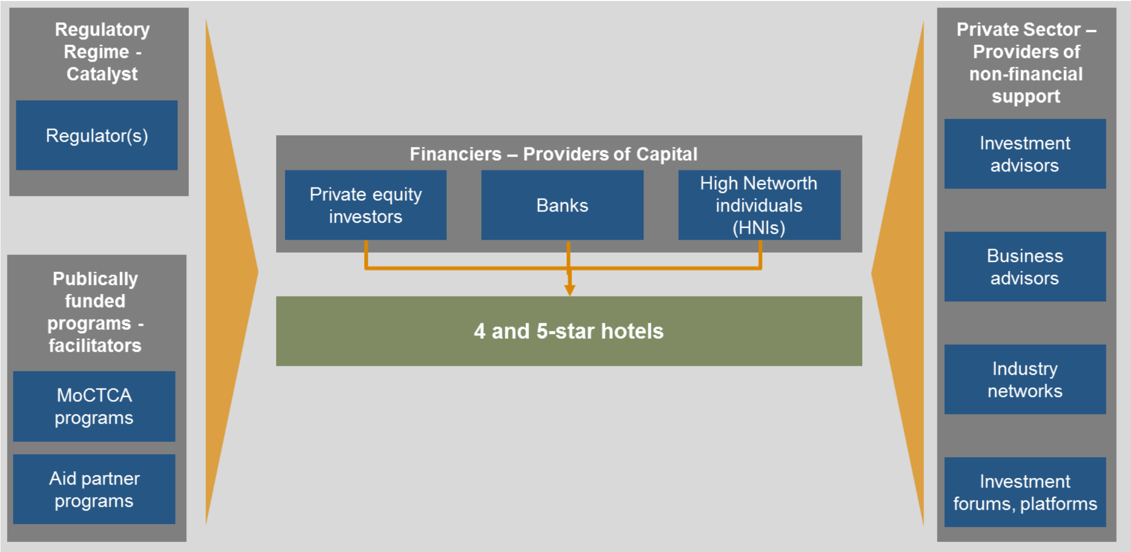
The repatriation of capital is a challenge for foreign equity investors in Nepal: at present the repatriation of capital to a foreign country (except India) requires approval from the different departments in the Nepal Rastra Bank (NRB) and department of industries and is often discretionary[210]. Given the uncertainty in the policies and regulations of future governments due to political instability, this discretion could be major hurdle for foreign investors in exits.

7.4 Enablers Needed for Exit

The government and its aid partners, the regulatory regime, and private sector can work in a complementary fashion to build enablers needed for exit as shown in **Error! Reference source not found.**. When these actors begin to harmonise their functions, an "ecosystem" for equity investments begins to emerge as has been observed in the case of Silicon Valley; and more recently in India and parts of East and South Africa.

206 SEBON Annual report 2011-12
207 SEBI annual report 2012-13
208 CSE directive 2012
209 SECBD website, 2013
210 Intellecap primary research

Figure 35: Typical ecosystem for private equity investments in emerging economies



Source: Intellecap analysis, 2014

Government and aid partners can create more impact by playing a facilitative rather than direct role

Government and aid partners could potentially create most impact by helping to decrease risk of investments; acting as anchor investors in funds; and bring in facilitative regulation like tax breaks and other incentives for tourism companies.

The creation of 'Guarantee funds' by public sector institutions can help to channel more debt and equity capital into tourism companies

Creation of guarantee fund by Public sector institutions, both for debt and equity products could provide commercial banks and private equity funds with partial coverage of risk exposure against investment made in tourism companies. This would ensure that the capital supply to such companies is not affected in the long term and this would facilitate further investments in the sector.

Building an ecosystem for the secondary markets to facilitate private equity investment exits through open offer would create more exit opportunities

More awareness about the nuances of equity investing would be beneficial for both entrepreneurs and investors. Industry networks, forums and conferences, incubators and investment intermediaries have a key role to play in building this awareness and creating a better ecosystem for equity investments. Historically given the low trading volumes in secondary markets in Nepal, an enabling environment for promoting secondary market transactions should be created[211]. The key drivers that would facilitate the trading volumes in the secondary markets in Nepal are – (a) introduction of reliable online trading system making trading affordable and (b) settlement of transactions to be shortened to a few days from the present duration that could last for few weeks.

Regulatory regime can play a key role in putting in place regulatory structures to allow exit platforms to emerge

Recognising equity investments as a separate asset class creates more formal structures and higher degree of organisation in the private equity market, which helps investors to navigate the processes of incorporation, licensing and approvals. This recognition can also pave the way for special

[211] Refer Annexure 9.4.3

concessions to private equity investors as well as create the foundation for public and private exit platforms to emerge.

Private sector actors like investment intermediaries can help to reduce duplication of efforts in deal sourcing and early stage capacity building; and highlight best case practices for the industry

Private sector actors like investment advisory firms; and industry networks and forums like conferences and workshops are efficient aggregators of high potential businesses. By playing this role, they can decrease duplication of effort in pipeline discovery across different private equity funds and also ease the process of fundraising for entrepreneurs by helping them navigate through different choices. This trend has been observed in India, where industry networks like TiE, FICCI and NASSCOM; private and public incubators; and forums like TIECON and Sankalp Forum have played a key role in helping the venture capital and private equity spaces grow.

8. Access to Capital

8.1 Access to finance amongst 4 and 5-star hotels

4 and 5-star hotels and resorts in Nepal have moderate access to debt but low access to institutional equity

Larger hotels and resorts interviewed during the course of this study reported that access to debt is comparatively easier in the hotel and resort business as collateral is available in the form of land and building. These firms are typically able to access debt at 10.5 to 12.59% interest rates[212]. However, access to institutional equity is low in the country due to the less developed state of capital markets[213].

Difficult to estimate quantum of debt funding, but the larger hotels and resorts seem to have easier access to debt funding and at better interest rates

In case of smaller hotels and resorts, access to debt is difficult due collateralisation requirements, high interest rates, and capping of loan terms at 8 to 10 years. Data with further granularity is not available, and hence it is difficult to accurately estimate flow of debt funding.

Overall, the supply of debt to businesses in Nepal appears to be inadequate since only 10% businesses report that they are well-served by the banking infrastructure, and only 1% have a commercial bank as source of financing[214]. Some common challenges associated with access to debt funding include:

- **Requirement of high collateralisation:** Banks tend to lend only to larger and well-established businesses and often require up to 100% collateralisation

- **Long lead times in loan approvals:** The process of procuring a loan can take from 3 months to over a year with significant time investment from senior management[215].

[212] From primary interviews conducted during the course of this study in May 2014
[213] See Section 11.4 for details
[214] IFC Enterprise Finance Gap Database, accessed in March 2014
[215] From primary interviews conducted during the course of this study

Equity funding in 4 and 5-star hotels and resorts primarily consists of FDI and promoter capital; very little organised private equity investing activity exists

Domestic promoter equity has been channelled by family-run business groups or High Networth Individuals including NRNs. Over US$ 125 million has also come in through FDI route from institutional as well as individual investors since 2005[216].

4 and 5-star hotels and resorts face several challenges in accessing institutional equity capital which include:

- **Low supply of organised equity funding** which means that promoters with existing relationships/networks built with financiers are more likely to be evaluated for investments
- **Low awareness about the pros and cons of raising external equity** which leads many hotel and resort promoters to be apprehensive about losing control of their company to an external investor
- **Very little activity in "investment intermediation"** from investment advisors and others who typically link investors and entrepreneurs in more mature markets
- **Lack of clarity in valuations** and nature of investment agreement
- **Lack of exit platforms**

8.2 Grants and Resources

There are several international financial and non- financial assistances available to businesses which Nepal can explore to bring in measurable operational efficiency and success within a company. Some of the relevant grants and resources along with their criteria have been listed below:

1. **Austrian Development Co-operation – Business Partnerships**

In cooperation with the Oesterreichische Entwicklungsbank (OeEB) the Austrian Development Agency (ADA) promotes Business Partnerships.

Activities that can be undertaken with the support of ADA:

- Improvement in initial training and vocational training
- Know-how transfer
- Use of renewable energies or increase in energy efficiency
- Improvement in water supply and waste water treatment
- Improvement in waste disposal and/or recycling
- Promotion of rural development and responsible management of natural resources
- Increase in production, competitiveness and quality
- Consolidation of supply chains
- Improvement in social standards and working conditions
- Improvement of the health of workers and their families, fostering gender equality

These measures can be supported as part of a business partnership with a non-repayable grant. Funding amounts to up to 50% of direct project costs (not exceeding EUR 200,000), which must total at least EUR 100,000. The term of a Business Partnership is limited to three years. The programme is open for applications all year round.

[216] See Section 5 for details

Criteria

ADA is interested in innovative and sustainable projects. To be eligible for funding, a project must meet the following conditions:

- Applicant is a European company in partnership with a company from a developing country.
- Generation of local added value, turnover and profits.
- Long-term commitment in developing country.
- Benefits for local population beyond the applicant's core business.
- Compliance with national laws and internationally recognised environmental and social standards.
- The project includes flanking measures that contribute both to improving the local social, ecological or economic environment and the success of the company.

Eligible costs

The application includes a budget according to ADA format. The following costs can be included:

- Time spending of project partners.
- Salaries of staff hired for the project.
- Local and international travelling and accommodation costs.
- Capital goods investments (only the annual depreciation costs are covered for the duration of the project).
- Costs of training, advisors, certificates, marketing, studies etc.

2. **German Development Co-operation - DeveloPPP**

The develoPPP.de programme provides up to 50% grant (maximum of Euro 200,000) to selected projects proposed by a European company or a company in a developing country in which European companies or nationals own at least a 25% share. The programme is funded by the German government and administered by its agencies DEG, GIZ and Sequa. These agencies hold ideas competitions four times a year for the develoPPP.de programme with the following closing dates: 31 March, 30 June, 30 September and 31 December.

Criteria

To qualify for develoPPP.de grant funding under the ideas competition, a project needs to have the following features:

- The applicant is a company registered in Europe or a company registered in a developing country with at least 25% European ownership.
- The applicant is at least 3 years active, has at least 10 employees and a turnover exceeding Euro 1 million.
- The applicant has a long-term entrepreneurial commitment in the target country and demonstrates a commercial interest in the project.
- The project should be completed within 3 years from contract signing.

Activities

DeveloPPP will co-finance exclusively projects that prepare or accompany long-term private sector commitments, like:

- Design and introduction of new products, technologies and services relevant to development; demonstration or pilot projects.
- Improvement of range of courses offered at training institutes.
- Improvement of energy and water supply.
- Improvement of healthcare.
- Job creation.
- Improvement of labour and social standards.
- Measures to boost environmental and climate protection.
- Supply chain management.
- Economically and socially responsible value chain management.

Eligible costs

The application includes a budget according to DeveloPPP format. The following costs are eligible:

- Time spending of project partners.
- Salaries of staff hired for the project.
- Local and international travelling and accommodation costs.
- Capital goods investments (only the annual depreciation costs are covered for the duration of the project).
- Costs of training, advisors, certificates, marketing, studies etc.

3. German Development Co-operation – Up-scaling

With the special programme "Up-Scaling", DEG finances pioneer investments of small and medium enterprises (SME) in developing and emerging countries that intend to scale up innovative business models. The programme addresses companies whose financing needs lie somewhere between micro financing and the traditional financing by commercial banks.

Target group

SMEs that are registered in the developing country- This may also be local subsidiaries of German or European companies. The applicant company has to provide the resources in terms of finance and manpower as well as the relevant know-how to implement the project and needs to be able to present at least one annual financial statement.

Funding

DEG finances a maximum of 50% of the total investment volume (max. EUR 500,000) under the condition that there are private sponsors who contribute a substantial share of equity (at least 25%). The DEG share must be repaid in the event of success of the project (depending on pre-defined financial criteria such as cash flow, revenue or profit).

Conditions of co-financing

- The project is based on an innovative business approach.
- A pilot phase has already been successfully completed with proof of concept as regards to technology and business model at local level.
- The project must generate profit (proof by means of business plan and financial projections).

- The project shows high growth potential owing to the size of the market and the target group.
- The project may generally be planned in all developing or emerging-market countries, with individual limitations owing to political or other risks. Projects in Africa and in LDCs (least developed countries) will be considered preferentially.

Interested companies may deliver their proposals for the co-financing to DEG at any time.

4. Dutch Development Co-operation – Food security and private sector development programme (public-private partnership)

The programme aims to stimulate public/private partnerships of Dutch and local partners within the sphere of food security and private sector development in developing countries. There is one tender round in 2014, closing on 1 December 2014.

Target group

Grants are available to public institutions, businesses, NGOs and knowledge institutions, within a cooperative partnership which encompasses at least one business. The public component in the partnership will, in every case, comprise the Dutch Ministry of Foreign Affairs. Participation by an NGO is mandatory. Preferably, other public institutions will also form part of the cooperative partnership.

Sub-themes

For food security:

- Improved local/regional availability of affordable and qualitative good food.
- Efficient markets and sustainable chain improvement in local/regional markets.
- Not eligible: projects exclusively aimed at non-food crops

For sustainable entrepreneurship:

- Inclusive business proposals with demonstrable impact on low income groups
- Improvement of female entrepreneurship
- Not eligible: proposals aimed at the financial sector (excluding insurance)

Grant

Maximum 50% of budget with project budget of minimum EURO 2 million. Minimum 25% of project budget must be financed by private enterprise.

5. Norwegian Development Co-operation – Application-Based Support for Private Sector Actors

Activities

The programme is primarily aimed at businesses / commercial companies seeking funding for:

- **Feasibility studies** (maximum 50% of budget with maximum grant of EURO 60,565). Norad primarily covers the costs made in the development country.

- **Preliminary studies** may include market, technology, legislation, etc.

- **Training** related to establishment (maximum 50% of project budget with maximum grant of EURO 60,565). Support can be given to training of local employees for a limited time in connection with establishment, in cases of major expansions or restructuring.

- **Pilot production/demonstration** in connection with private investment projects / business establishment (maximum 50% of total costs with maximum of EURO 121,000). In the starting phase of production in a developing country, there may be doubt on whether the chosen technology is appropriate to the local conditions.

The purpose of the programme is to reduce the risks present before an investment decision is made and to secure the sustainability and feasibility of the investment project.

For companies seeking funding it is important to note the following:

- Some sectors are prioritised (renewable energy, climate and environment-related technology, agriculture, forestry, marine and maritime sector).

- Requirements of at least EURO 1.2 million in turnover for the last year.

- The applicant should normally have, or plan for, an ownership of at least 25% in the established/ planned company.

- The applicant must show a high development effect to be probable.

- Sales and representation offices will not be supported.

Applications can be submitted continuously.

6. **Swedish Development Co-operation – Innovation Against Poverty (IAP)**

Applicants can be based in any country, but their inclusive business must be in a low-income country (OECD/DAC list). The programme functions as a risk sharing mechanism for sustainable business ventures (commercial companies or market oriented organisations) which have a strong potential to reduce poverty. Companies can be active in all sectors where innovation leads to poverty reduction, from agriculture and infrastructure to health and education.

Grants: Innovations Against Poverty has two parallel application processes:

- **Small grants** (maximum 50% of project costs with maximum of EURO 20,000) for the purpose of exploring an innovation or a new market. The grant can be used for travel and pre-feasibility studies; stakeholder needs assessments, and networking with local organisations. This programme focuses on smaller organisations which have a wealth of good ideas with great potential, but need the support of their business strategy and resources to penetrate new markets.

- **Large grants** (maximum 50% of project costs, in the range of EURO 20,000 – EURO 200,000) for the purpose of undertaking a development project aimed at a product, service, system, business model or a concept ready to be put to market test, or adaptation of existing products to be affordable and accessible by the poor. IAP also seeks to work with larger companies, to help support the development of "inclusive business" models for these markets, which expands opportunities for the poor and disadvantaged in developing countries. Such business models can engage the poor as employees, suppliers, distributors and consumers.

Key criteria: development effects, commercial viability, innovation, cost sharing and additionality.

The process is of a competitive nature, where grants are awarded to the best business plans which meet the criteria of the programme. The programme works with 1-2 tender rounds per year. No tender round has been announced at present.

7. **USAID**

There are several programmes under USAID that are applicable for Nepal such as:

- Powering Agriculture
- Development Innovation Ventures
- Partnering for Impact
- Partnering to Accelerate Entrepreneurship
- Partnering for Innovation

9. Typical Capital Structure in 4 and 5-Star Hotels and Resorts

Typical emerging market 4 and 5-star hotels and resorts have debt-heavy capital structures during initial years of operations, with debt component steadily decreasing as the business grows

Hotels and resorts typically need access to debt for purchase of land, building constructions, and fixtures and interiors in their initial stages. This debt is usually long term, and is paid back within a 5 to

10 year window depending on financial health of the business. During this period, the debt:equity ratio is typically 70:30 in emerging market economies like India, Indonesia, Malaysia, and Thailand[217].

As the business grows and matures and long-term debt is paid off; the overall debt component decreases. However, these businesses have cyclical requirements of medium to long term debt for expenditure on facility upgrades and expansion, and periodic replacement of fixtures and furnishings. They also need short term debt from time-to-time for operational expenditure on salaries and maintenance. As a result, the steady-state debt:equity ratio can range from 50:50 to 20:80[218].

Capital structures of 4 and 5-star hotels and resorts in Nepal align with this industry trend

The capital structures of hotels and resorts in Nepal also align with the emerging market trends in capital structures as shown in Table 22. Their capital structures are debt-heavy in initial years, but as the businesses grow and long-term debt is paid off; the overall debt component decreases.

Early stage private limited companies interviewed during the course of this study reported debt:equity ratio of 70:30; while the more established and public limited companies shown in Table 6 show a median debt:equity ratio of 30:70.

Table 15: Typical capital structure of 4 and 5-star hotels and resorts in Nepal

	Capital Structure in Nepal	
	Debt	Equity
Private Limited 4 and 5-star hotels and resorts	70%	30%
Public Limited 5-star hotels	30%	70%

Source: Primary interviews conducted during the course of this study in May 2014; annual reports of Oriental Hotel, Taragaon Hotel and Soaltee. Median values for D/E taken.

4 and 5-star hotel promoters who prefer institutional equity often do so for strategic reasons like improving brand value and enhancing management capacities

Not surprisingly, 4 and 5-star hotel promoters who prefer equity seemed to do so for the “non-financial” value-add it creates; and sought enhanced brand value, improved outreach to foreign tourists and improved management capacities as key contributions expected from an equity investor as shown in Figure 36.

217 Venture Intelligence and Intellecap analysis, 2014
218 Venture Intelligence and Intellecap analysis, 2014 – see in Table 26 in the Annexure for complete sample set

Figure 36: Typical tourism business promoter preferences in capital structures

Sub-sectors	4 and 5-star hotels and resorts
Preferences for type of external funding	
Debt	●
Equity (Domestic or Foreign)*	◐
Key contributions expected from an equity investor	
Improved access to foreign tourists	●
Increased brand value	●
Enhance management capacities	●
Adding financial value only	○
Help to unlock promoter capital by dilution	○

**No specific preference was found between foreign and domestic equity*

● High
◐ Moderate
○ Low

Source: Primary interviews conducted during the course of this study in May 2014

10. Valuation Trends in Tourism

Enterprise valuation in Nepal can often be challenging because – (a) there is limited historical data; (b) there is a lack of adequate industry benchmarks, and (c) the use of comparable data from SAARC countries is only partially adequate.

There is little public information available on past equity investments into tourism companies in Nepal aside from publically listed firms (in Table 6). The lack of data is primarily due to infancy of the investment value chain and support infrastructure such as research and ratings. Further, sparse research coverage of capital markets in Nepal has resulted in limited availability of historical data and limited access to updated industry benchmarks.

However, the investment landscape, particularly in the tourism sector[219], is witnessing brisk activity, with 2-3 institutional investment funds setup over the last three years. The status of investment landscape presents an opportunity for early entrants into the venture capital space in Nepal to make investments at lucrative valuations.

In the absence of adequate industry benchmarks relevant proxy, comparable data and hurdle rate methods may be used to guide valuation

Since adequate industry benchmarks from Nepal are not easy to access; **valuation data from comparable** countries like India and Sri Lanka may be used as broad guides by investors. These countries are comparable because like Nepal, they have inherent tourism strengths like natural beauty and historical monuments; and the tourism industry makes significant contributions to GDP and employment. They are also reliant on inbound tourism and suffer from many of the infrastructure

[219] From primary insights garnered during the course of this study in May 2014

related challenges like poor waste management at populated tourism destinations. At the same time, countries like India have much higher market capitalisation and better investment value chains, and have several publically listed and traded tourism companies. Hence, even though some comparable valuation ratios can be used from these countries, they can at best be broad guides since the regulatory regimes, banking infrastructure, market capitalisation and other macro-economic indicators vary widely from country to country.

In absence of consistent data on valuation ratios in the sector, **hurdle rate** can also serve a good indicator of minimum returns expected from investments in the tourism sector. The two benchmark rates considered for the analysis include (a) Cost of Equity and (b) Weighted Average Cost of Capital (WACC) for a given financing mix of equity and debt.

10.1 Valuation of Listed 5-Star Hotels in Nepal

The Nepal Stock Exchange has 4 listed 5-star hotels, of which 3 are actively traded and report on their financial performance as shown in Table 7. Based on the financial performance reported by these 3 firms over the past two years[220], their valuation multiples have been calculated as shown in Table 16.

Table 16: Valuations of 5-star hotels listed on NEPSE

Listed Companies	ROE%		P/E		EV/EBIDTA		EV/Sales	
	2012	2013	2012	2013	2012	2013	2012	2013
Soaltee Hotel	23%	21%	27.37x	35.18x	22.97x	25.91x	6.43x	7.09x
Taragaon Regency Hotel	3%	5%	39.55x	16.96x	12.65x	6.72x	3.52x	2.30x
Oriental Hotel	16%	22%	5.41x	6.64x	14.91x	9.95x	5.08x	3.66x

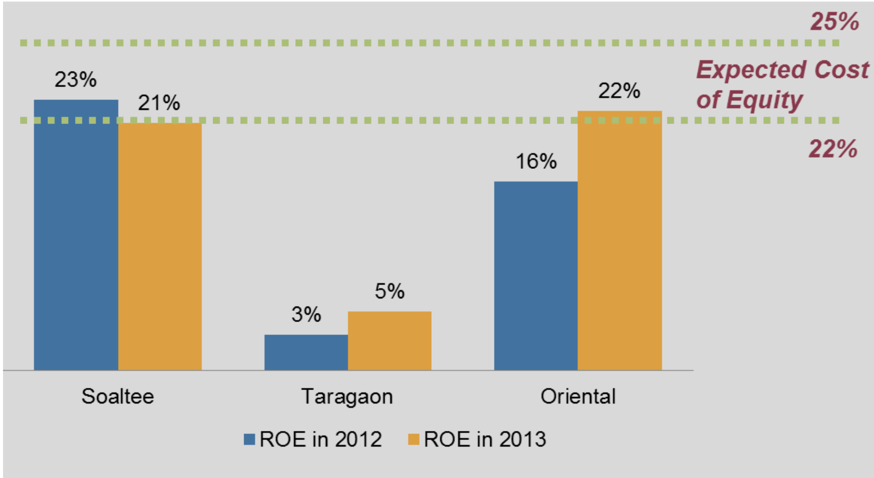
Source: Annual reports for Soaltee, Taragaon and Oriental; and Intellecap Analysis, 2014

A comparison of ROE and cost of equity could be used to evaluate if a firm is adding value to investors

The cost of equity in listed and more established hotels is found to be 22 to 25% using the assumption of capital structure for mature firms shown in Table 15. When compared against the ROE% of listed 5-star hotels in Nepal, Oriental Hotel and Soaltee are found to be more likely to add value to investors as shown in Figure 37.

[220] Historical financial information prior to FY 2012 was not available.

Figure 37: ROE and cost of equity analysis of listed 5-star hotels in Nepal



Source: *Annual reports for Soaltee, Taragaon and Oriental; and Intellecap Analysis, 2014. Please see Section in Annexure for notes on calculation of cost of equity. D/E of mature hotel companies has been assumed for calculations in this case.*

10.2 Comparable Valuations in India and SAARC Countries

Valuation multiples from comparable countries like India and Sri Lanka may be used as broad indicators by investors evaluating opportunities in 4 and 5-star companies as shown in Table 17. Data from comparable countries has been used due to inadequacy of public data on valuation trends in Nepal. Countries like India and Sri Lanka are found to comparable because – (b) they have inherent natural, cultural and spiritual tourism "pull-factors" like Nepal; (b) significant reliance on inbound tourism; (c) tourism is a key contributor to GDP and employment; and (d) they have common infrastructure related challenges like poor waste management at populated tourism destinations

Table 17: Median of valuation multiples of some listed hotels and resorts from SAARC countries

	ROE %	EV/ EBIDTA	EV/Sales	P/E
Hotels and Resorts	6.9%	9.32	2.46	14.7

Source: Data for valuation multiples is based on financial statements of publically traded companies in India, Sri Lanka, Indonesia, Malaysia, Bangladesh and Pakistan. The specific value represented here is the median of multiples of several companies – the details can be accessed in Section 11.5.3 in the Annexure. Information on financial statements was accessed from Capital IQ, Bloomberg and MoneyControl databases in March 2014.

Note: Due to limited size of sample set, this should only be taken as a broad guide to valuation multiple ranges. Specific valuation multiples may differ significantly from company to company.

10.3 Estimating Hurdle Rate for Tourism in Nepal

Hurdle rate is proposed as an indicator of minimum expected return from investments in 4 and 5-star hotels and resorts

In absence of consistent data on valuation ratios in the sector, hurdle rate can serve a good indicator of minimum expected return from investments in the sector. The two benchmark rates considered for the analysis include (a) Cost of Equity and (b) Weighted Average Cost of Capital (WACC) for a given financing mix of equity and debt. Finance literature offers multiple methods of calculating the hurdle rates; the current report uses the Damodaran Model (refer to annexure). As Nepal's investment value chain is in early stages of its development, investors may seek premium for illiquidity and size of the investments.

Cost of Equity in 4 and 5 star hotels and resorts in Nepal ranges from 37% to 42%

Based on the data from the tourism sector in Nepal and comparable proxies, the Cost of Equity for investments in 4 and 5-star hotels and resorts is estimated to vary from 37% to 42%; and Weighted Average Cost of Capital is estimated to be 17% to 19%. The key assumptions for the estimations are listed in Table 18 and ranges for Cost of Equity are presented in Table 19.

Table 18: Key assumptions taken to calculate WACC in 4 and 5-star hotels and resorts in Nepal

Parameter	Assumptions
Market value of Debt (D)	The data for debt component presented in Table 15 has been used.
Market Value of Equity (E)	The data for equity component presented in Table 15 has been used.
Tax rate	Corporate tax rate of 25% has been taken[221]
Cost of debt in Nepal	The data from major banks in Nepal such as SBI Nepal and Bank of Kathmandu has been utilised to obtain the cost of debt. The range of cost of debt has been taken at 10.5 to 12.5% as per information gathered during primary interviews conducted in the course of this study
Risk Free Rate	Taken at 9% based on the bond rates reported by Nepal Rastra Bank
Beta estimation	• Beta for 4 and 5-star hotels and resorts in frontier markets has been estimated to be 0.74 based on data analysed from comparable geographies • The beta has been levered using Debt equity ratio for 4 and 5-star hotels and resorts in Nepal as shown in Table 15. This gives the levered beta value of 2.04
Market Risk Premium (Rm)	The market risk premium ranges from 13.66% to 16.25%[222]

[221] Inland Revenue Department, Nepal statistics
[222] See calculations in annexure

Table 19: Cost of Equity across 4 and 5-star hotels and resorts

	4 and 5-star Hotels and Resorts
Cost of Equity (min)	37%
Cost of Equity (max)	42%

Source: Intellecap analysis, 2014

4 and 5-star hotels and resorts are found to have a higher cost of equity primarily due to a heavy reliance on long-term debt for construction and operations of facilities in the first 7 to 8 years. As a result, the capital structure of a typical luxury hotel or resort has up to 70% debt in initial years, which decreases to 30 to 40% debt component for mature companies.

Cost of Equity and leverage are considered together to estimate the Weighted Average Cost of Capital (WACC)[223] using the formulae shown in Table 20.

Table 20: Estimated hurdle rate for 4 and 5-star hotels and resorts in Nepal

	4 and 5-star hotels and resorts
D/E	2.33
Beta Unlevered	0.74
Beta Levered	2.04
Total Equity Risk Premium	13% to 16%
Risk Free Rate	9%
Cost of Equity	37% to 42%
Cost of Debt (min)	10.5% to 12.5%
Tax Rate	25%
Weighted Average Cost of Capital	17% to 19%

Source: Intellecap analysis, 2014

10.4 Non-Financial Metrics used in Valuation

The most important non-financial metrics for valuation of 4 and 5-star hotels and resorts are location, brand recognition, strength of management team, robustness of operational model, and strength of customer acquisition channels.

[223] See Section 7.2 for details on calculation of hurdle rate

Valuation of 4 and 5-star hotels and resorts, especially in frontier markets, must take into account both quantitative and qualitative indicators of firm value. These include "firm-level" criteria and "macro-economic and market-level" criteria.

A small group of early stage equity investors from India were asked to evaluate the relative importance of these valuation drivers to understand investor sentiment on this issue. Not surprisingly, investors rated location, brand recognition, strength of management team, robustness of operational model, and strength of customer acquisition channels as the most critical aspects of a hotel/resort business and favourable metrics against these were likely to drive up valuation. More "systemic issues" like regulation issues, exit opportunities, and inflation were not considered very critical and investors were likely to make more concessions here unless there was a direct impact on revenues and profitability. Table 21 shows a "high", "moderate", and "low" sorting of these criteria.

Table 21: Investor sentiment on non-financial valuation drivers in 4 and 5-star hotels and resorts

Valuation Drivers	Investor Sentiment on Relative Importance		
	High	Moderate	Low
Firm-Level Drivers: Internal			
Location	✓		
Brand recognition	✓		
Management team	✓		
Strength of operational model – margins, scalability	✓		
USP	✓		
Strength of customer acquisition channels	✓		
Collateral and securities		✓	
SME-Level Drivers: External			
Regulation – sector-level policies, legal structures, taxation		✓	
Exit opportunities – like secondary sale, promoter buy back and IPO		✓	
Macro-Economic and Market-Level Drivers			
Government focus on driving tourism	✓		
Infrastructure	✓		
Political stability	✓		
FDI policies		✓	
Inflation		✓	

Source: Primary interviews and Intellecap analysis; 2014.
Note: A rating of "high" indicates that investors do not compromise on these drivers, of "moderate" indicates that they sometimes compromise if all other critical drivers seem favourable, and "low" indicates that investors compromise almost always because they expect these drivers to improve in the short-to-mid-term.

1. Location

Location is a critical criterion that predicts occupancy, average room rate, and average duration of stay for customers of 4 and 5-star hotels and resorts. Locations that have a good view, or are co-located with an important tourist attraction are more likely to attract a greater market share of the high value tourists in Nepal, and thereby report better financial performance. A location with positive attributes as enumerated here is likely to drive a higher valuation.

2. Brand recognition

Brand building in the hotels and resorts market is complex because end consumers often make purchase decisions based on influence of either a third-party like a travel agency or an e-commerce portal or driven by more nebulous influences like word-of-mouth. Hence, hotels and resorts that invest in multi-pronged brand building efforts are more likely to have higher valuations. A tie-up with an international hotel chain is especially helpful in augmenting brand value.

3. Management team

Quality and experience of the management and technical teams is the most critical aspect for private equity investors since they are mostly betting on the team's ability to turn a business plan into a profitable venture. This is especially true in Nepal where the larger supporting environment for businesses is missing; and the ingenuity, networks and skills of founding team members are called upon to bridge this gap. Presence of a strong management and separate technical team with diverse skillsets and clearly established roles and responsibilities will help to drive up valuation.

Good governance practices like maintaining audited financials, good book-keeping, and presence of a few external and well-reputed individuals on the Board of Director or Advisors help to drive up valuation.

4. Strength of operational model – margins, scalability

The strength of operating level cash flows help to determine financial state of 4 and 5-star hotel and resorts, and investors analyse these to estimate the predictability of revenue. Key metrics to measure operational efficiency for hotels and resorts have been described in Section 6.1.1, and include metrics such as number of rooms, average occupancy rate, and average room rate.

Such healthy metrics indicate predictability in revenue; such that it sufficiently covers operational costs and services debt. An operationally efficient business that shows healthy metrics is likely to have a higher valuation.

5. USP

The key customer segments for 4 and 5-star hotels and resorts include high value leisure and business travellers from domestic as well as international markets. Since the purchase of services from 4 and 5-star hotels and resorts falls under the purview of "luxury category", it is important to have a well-defined and aspirational USP to attract customers. USPs in the hotels and resorts business can range from international brand tie-ups to location to "special themes and attractions" like golf courses, ayurvedic spas and heritage buildings. USPs like these tend to influence customer decision-making process to a high degree and are likely to drive up valuations.

6. Strength of customer acquisition channels

4 and 5-star hotels and resorts rely on both B2B and B2C channels for customer acquisition. B2B sales are primarily driven by travel agencies and B2C sales by international e-commerce platforms like TripAdvisor, corporate websites and direct walk-ins. Hotel and resort companies that have strong

tie-ups with travel agencies or even operate their own travel agencies are more likely to attract higher number of customers. Similarly, hotels and resorts with active online presence on e-commerce platforms, well-developed and search engine optimised websites for e-bookings, and prominent advertising/brand placements at international airports are more likely to win business directly from customers. Hotels and resorts that have tie-ups with international hotel chains also benefit from the centralised sales and booking infrastructure operated by such chains.

Overall, hotels and resorts with strong B2B and B2C sales channels are more likely to have higher occupancy and revenues, and hence higher valuations.

7. Collateral and securities

The availability of collateral and securities with a hotel or resort helps to gauge financial health, and also services to mitigate risks for an equity investor. Securities like debt funding and owner's equity can contribute to driving up a firm's valuation; while collateral like land bank in addition to this direct influence is also a signal to the equity investor that the firm can raise debt financing to grow.

8. Regulation – sector-level policies, legal structures, taxation

Facilitative government policies like encouraging FDI and ease of doing business increase valuation of hotels and resorts, while inhibitory policies decrease valuation. Section 4.3 explains the current impact of different government regulations on enterprise value and operations. The current regulatory regime is positive and likely to drive up valuations.

9. Exit opportunities – like secondary sale, promoter buy back and IPO

Clarity on potential exit opportunities is important as well. The secondary sale value-chain in Nepal is underdeveloped[224] so the only two strong possibilities that investors have are promoter buy-back and trade sales. Thus far, no track-record of secondary exits or a limited track record of public listing is available, and early entrants in the private equity field in Nepal may have to plan for a longer investment time-period than in more mature markets. This could drive down valuations due to higher risk perceptions.

10. Government focus on driving tourism

Investors also tend to place a high degree of importance on government's support for the tourism industry. Government provides support to the sector by way of running promotional campaigns and improving transport and tourism-related infrastructure. Ambitious government plans and high budgetary allocations tend to build up investor confidence in the macro-economic environment for tourism projects.

11. Infrastructure

The current and projected state of infrastructure including airports, roads, tourist facilities, and maintenance of key tourism destinations also play a key role in investment decisions. Improving state of infrastructure tends to drive up investor confidence in a country's ability to attract tourists, and in turn drives up confidence that a hotel or a resort property will have demand in the market.

12. Political stability

Confidence in the macroeconomic environment and political stability drives up firm valuations as it gives financiers confidence that the business environment for their portfolio will remain reasonably conducive, and at the same time their investment will be protected. Since Nepal has only regained

[224] See Section 7 for details

political stability over the past 6-7 years, investors are likely to attach greater risk premium to opportunities they evaluate as shown in Table 20.

This is an especially critical factor for private equity investors in tourism since political instability and civil unrest can have a negative impact on inbound tourism as was witnessed in Nepal between 2000 and 2006[225].

13. FDI policies

Long-term regulatory stability around FDI policies is likely to drive investments at greater valuation since investors can be confident that they will have the freedom to exit a business when it is most lucrative for them to do so. The recent decision by NRB to disallow FDI in commercial banking could potentially drive investors to attaching a higher risk premium. However, on the flipside the government and regulator have stated their intention to support greater FDI inflows, and in a March 2014 address, NRB Governor indicated that domestic banks and financial institutions are able to provide supplementary capital to foreign investors. Approaches like this would give more confidence to investors and drive up valuations.

14. Inflation

Nepal reported an inflation rate of 9.72% in January 2014, and both the current rate of inflation as well as historic trends compare unfavourably to other SAARC countries as shown in Figure 22. This degree of inflation could potentially decrease value of earnings for investors and in turn reduce the P/E ratio. In order to build a cushion against this, investor may consider addition risk premium and this may in turn drive down valuations. In addition to decreasing value of earnings for investors, inflation can also drive up prices and negatively impact inbound tourism as discussed in Section 3.5.

11. Annexure

11.1 Demand and Supply Assessment Methodology

Demand assessment for hotels and resorts was done using number of tourists visiting Nepal from various countries and according to purpose of tourism, mostly relying on secondary data from NTB

Growth rate is forecasted according to past 6 years CAGR of the inbound tourists visiting Nepal. An optimistic growth rate is also used to indicate the high growth if the systematic challenges are addressed. Forecasted occupancy rates are taken as per the present average occupancy rates in 4 and 5 star hotels in Nepal. Share of F&B is considered as per an average tourist expenditure breakup for Nepal.

Supply assessment of hotels and resorts was done based on existing hotels and new investments pouring in hotel industry, using a combination of primary data and secondary data about upcoming luxury hotel investments in Nepal

Supply of room-nights in 4 and 5 star hotels in Nepal is considered constant till 2017 due to no new plans for new hotels till 2016.

[225] Decline in inbound tourism between 2000 and 2006; from MoCTCA Tourism Statistics 2012 report

11.2 Methodology for Estimating Market Opportunity

The market opportunity for luxury hotels and resorts was estimated based on high-budget foreign tourists as key revenue drivers. The number of high-budget foreign tourists was assumed based on trends in current purchase of luxury room nights as explained in Table 22.

Table 22: Estimating number of high-budget foreign tourists in Nepal

S.No.	Metric	Data	Source
1	Total inbound tourists	0.8 million	Government data
2	Average length of hotel stay	7 nights	Primary interviews, triangulated against government data which reports average stay in Nepal as 12.87 days
3	Average number of tourists per room	2	Primary interviews
4	Approximate number of room nights sold (across all types of hotels)	5.13 million	Calculated from metrics 1,2,3
5	Typical occupancy rates for 4 and 5 star hotels	60%	Conservative estimate – based on government data and primary research. The best performing 4 and 5-star hotels reported occupancy of 80% during primary research
6	Number of 5 star and 4 star room nights sold	0.99 million	Calculated based on number of rooms shown in Table 1, and metric 5
7	Sales of 4 and 5 star rooms as a % of total rooms sold	19%	Calculated from metrics 4 and 6
8	Buyers of 4 and 5 star rooms as % of total buyers of hotel accommodation in Nepal	18 to 20%	Estimated from metric 7

Source: MoCTCA, Tourism Statistics Nepal, 2012; and primary interviews conducted during the course of this study in May 2014

Based on this data, the market opportunity for luxury hotels and resorts in serving the high-budget segment was calculated as shown in Table 23.

Table 23: Calculating market opportunity for luxury hotels and resorts in Nepal

S.No.	Metric	Data	Source
1	Reported number of 5 star and 4 star room nights sold	0.99 million	Government data
2	Typical rate per room night	US$ 140 for 5-star and US$ 100 for 4-star	Primary interviews and as per hotel websites
3	Revenue from rooms	Approximately US$ 60 to 80 million	Calculated from metrics 1 and 2
4	Typical F&B revenue, as a % of room revenue	30%	Based on primary interviews and India data,

			including revenues from restaurant sales, room service sales, and MICE-related banqueting
5	Revenue from F&B	Approximately US$ 20 to 25 million	Calculated from metrics 3 and 4
6	Total revenue	US$ 80 to 100 million	Calculated from metrics 3 and 5

Source: MoCTCA, Tourism Statistics Nepal, 2012; and primary interviews conducted during the course of this study in May 2014

11.3 Calculation of Hurdle Rate

Cost of Equity and leverage are considered together to estimate the Weighted Average Cost of Capital (WACC) using the formulae shown in Figure 38 and Figure 39.

Figure 38: Formula for calculating WACC

$$\text{WACC} = \frac{D}{D+E} \text{ X } (\text{1-tax rate}) \text{ x Kd} \;+\; \text{Ke x } \frac{E}{D+E}$$

Where -

D: Market value of Debt, **E:** Market Value of Equity, **Tax rate:** corporate tax rate in Nepal, **Kd:** Cost of debt in Nepal, **Ke:** Cost of equity calculated by the formula:

Figure 39: Formula for calculating cost of equity

$$\text{Ke} = \text{Rf} + \text{ß x (Rm- Rf)}$$

Where –

Rf: Risk free rate (treasury bond rate), **ß:** Predicted equity beta, **Rm:** Market risk premium

Cost of preferred stock has not been included while calculating WACC as the capital market information on the same was not available in Nepal. The key assumptions made while calculating WACC for tourism in Nepal are shown in Table 18.

The following methodology has been used to assess Market Risk Premium and Hurdle rate:

- Current risk premium was taken for a mature equity market at 5%
- No shadow rating is given by Moody's or S&P for Nepal. Based on ratings given by IFC at CCC+ (CAA1 in Moody's) the default spread is 7.5%. This has been multiplied by volatility factor of 1.5 for frontier markets to reach country risk premium of 11.25 % for Nepal. This is done because equity markets are about 1.5 times more volatile than bond markets.

- Alternately we can calculate country risk premium using volatility of stock markets.
  *Default Spread= US bond rate * (σ Nepal Stock/ σ US Stock)*
- US bond rate is taken as 5% and 5 years standard deviation of Nepal Stock was calculated using stock market data and comes out to be 219. The corresponding 5 years standard deviation of US Stock market comes out to be 190. Utilising this data default spread has been estimated is 5.77%. This has been multiplied by volatility factor of 1.5 for frontier markets to reach country risk premium of 8.66 % for Nepal.
- We take minimum and maximum values obtained from both methods to get a range of Total Equity risk premium to be 13.66% to 16.75%.
- Through our primary research, we found that the average D/E ratio for hotels and resorts in Nepal is generally 70:30. The values shown in Table 15 were also benchmarked against comparable countries like India and Sri Lanka.
- Unlevered Beta for hotel and resort sub-sector is estimated at 0.7409 across the sub-sector in comparable countries like India, Bangladesh, Pakistan and Sri Lanka. Hence a conservative estimate assumption across sub-sectors was taken, and further levered using the aforementioned D/E ratio and following formula -
  *β levered = β unlevered * (1 + (1- tax rate) * D/E)*
- The levered beta comes out to be 2.04 across the sub-sector
- The risk free rate can be obtained from major banks in Nepal such as SBI Nepal Rastra Bank and Bank of Kathmandu and comes out to be around 9-10% as yielded by most of the banks on bonds issued.
- Cost of equity can be calculated by using following method-
  Ke = Rf + β (mature market equity risk premium + country risk premium)
- Ke comes out to be in the range of 37 to 42% across the sub-sector
- Through our primary research in Nepal we found out that most hotels access debt in range of 10.5-12.5% interest
- WACC or the hurdle rate can then be calculated using the following formula-
  *WACC = E/(D+E) * Ke + D/(E+D) * (1 – tax rate) * Kd*
- WACC comes out to be in the range of 17% to 19% across the sub-sector

11.4 Investment Markets in Nepal and Impact on SME Valuation

11.4.1 Overview of Capital/Investment Market in Nepal

Role of capital in economic growth for any country is universally accepted and the fluctuations in the index of capital market could be seen as the barometer of economic performance. The capital markets in Nepal are sustained by the shares of banks, financial institutions and insurance companies that contribute to over 75% of the market capitalisation[226]. There is minimum presence of real sector in the capital market in Nepal but off-late there is an increasing presence of hydropower companies on the stock exchange.

The Nepal stock market or NEPSE since its establishment in 1992-93 has seen the number of companies listed in 1994 at 66 to 230 companies in 2013[227]. Despite the increase in the number of listed companies, it is estimated that only 10% of the companies registered on Office of the Company

[226] Nepal stock exchange website
[227] Nepal stock exchange website

Register are listed on NEPSE[228]. This in turn could indicate that firms in Nepal tend to avoid stock market as an alternative source of long-term capital[229].

Primary capital market in Nepal is quite diversified and securities such as Debentures, Ordinary Share and Right Share are used for training the market place. Out of the total approvals for public issues in 2013 as shown in **Error! Reference source not found.**; 30 companies got approvals for initial public ffering (IPO) of US$ 33.02 million, a substantial increase of over 130% on the amount when compared with the previous year. Political stability and institutional support was considered as the key reason for the spurt of activity in the primary capital.

Table 24: Primary approval issued by SEBON for the FY 2012/13

S. No	Types of Securities	FY 2012-13		FY 2011-12	
		No of Issues	NRs In Million	No of Issues	NRs In Million
1	Debenture	7	3550	3	1200
2	Ordinary Share	30	3114	15	1298
3	Right Share	5	3939	7	452
	Total	**42**	**10602**	**25**	**2950**

Source: NEPSE Annual report 2012-13;
Note: currency rates shown are in Nepalese Rupee. At the time of writing this report; the exchange rate was 1 US$ = 94.19 Nepalese Rupee.

The general investors in Nepal are still are attracted only toward primary shares. The fact that initial public offering (IPO) is listed many times more than that invited by the companies making IPO in the primary markets but the transactions in the secondary market is very low. This in turn shows the lack of awareness about capital market and trading in general in Nepal.

Trading in secondary markets in Nepal is a major challenge due to high trading and transaction costs, long duration of settlements and lack of reliability in the transactions.

11.4.2 Nepal Investment Market Valuation and Key Drivers

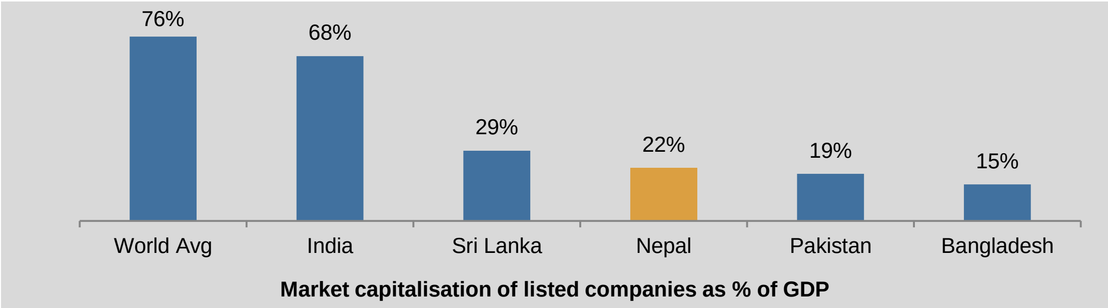
The three key parameters to measure the capital market development for Nepal have been discussed briefly below. They are a) Market Capitalisation Ratio (MCR), b) Total Value Traded Ratio (TVTR) and c) Turnover Ratio (TR)

[228] Department of industry, Industrial statistics 2012-13
[229] Stock Market Development and Economic Growth report, Dr. Udaya Raj Regmi, 2012

In terms of Market Capitalisation Ratio (MCR), Nepal ranks the third best in the SAARC region after India and Sri Lanka. However the MCR in Nepal is very low in comparison to the world average and India as shown in

Figure 40. A lower MCR in Nepal indicates that the stock market is yet to show its impact on the economic activities of the country.

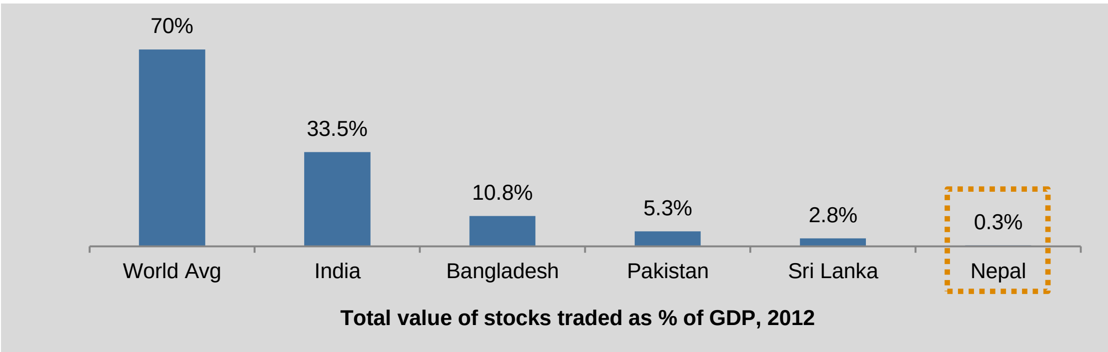
Figure 40: Market Capitalisation Ratio (MCR) for SAARC countries



Source: World Bank Development Indicators database, accessed in March 2014

Total Value Traded Ratio, as a market liquidity indicator, shows that Nepal has one of the lowest values of shares traded in the world when compared to its GDP as shown in Figure 41. This indicates the illiquidity in secondary markets in Nepal and that trading is very costly and difficult. One of the key reasons for increased cost of trading is the reliance on legacy based data systems for trading and absence of an online platform for trading.

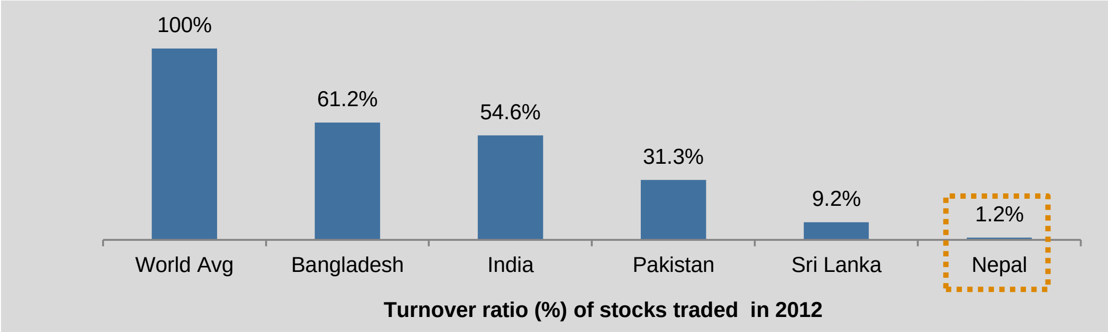
Figure 41: Total Value Traded Ratio (as % of GDP) in SAARC countries



Source: World Bank Development Indicators database, accessed in March 2014

The next measure of stock market development Turnover Ratio shows that Nepal has one of the lowest total values of shares traded to the average market capitalisation as shown in Figure 42. This indicates that trading and transaction costs are high in Nepal and buying and selling of shares in secondary markets is very difficult. Of all the three parameters, there are ample opportunities for Nepal to develop its capital markets fast by increasing turnover ratio even though market capitalisation is very low.

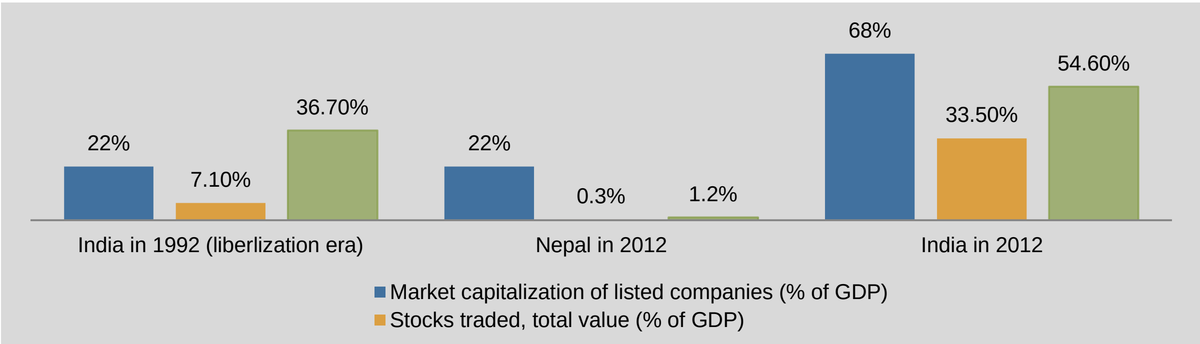
Figure 42: Turnover Ratio in SAARC countries



Source: World Bank Development Indicators database, accessed in March 2014

A comparison with the present stock market development indicators in Nepal with the Indian stock markets just after the liberalisation era in 1991-92 shows some similarity in the two stock markets. India has come a long way on secondary capital markets in the last two decades as shown in Figure 43. Nepal could witness the same pace of growth given the requisite institutional framework and investor friendly eco-system is put in place. Allowing foreign institutional investors to trade in secondary markets in Nepal could put the country on fast track development in capital markets.

Figure 43: Comparison of capital market development in Nepal with India



Data Source: World Bank Development Indicators database, accessed in March 2014

The key drivers that would facilitate the trading volumes in the secondary markets in Nepal are - a) introduction of reliable online trading system making trading affordable b) settlement of transactions to be shortened to a few days from the present duration that could last for few weeks and c) with higher GNIs per capita and increasing literacy levels emergence of a social class that is aware of the benefits of wealth creation through the secondary markets d) an expected long-term political stability would boost the confidence of investors to invest in the capital markets.

11.5 Miscellaneous

11.5.1 Legal Structures for Businesses in Nepal

Table 25: Legal Structures available to Businesses in Nepal

Structure	Description	Implications for financing
Sole Proprietorship	Only 1 shareholder allowed, registered with the Department of Cottage and Small-Scale Industry	Cannot issue shares or debentures and hence cannot take in equity investments

Structure	Description	Implications for financing
Private Limited (Pvt. Ltd.)	1 to 50 shareholders can register a Pvt. Ltd. company with the Office of the Company Registrar under the Companies Act. A company that intends to trade also needs to register with the Department of Commerce.	Can issue different types of shares and debentures with limited liability to shareholder; and hence is an appropriate structure for equity investments
Public Limited (Ltd.)	At the time of incorporation 7 shareholders can register a Ltd. company, but the actual number of shareholders should exceed 51. Also registered with the Office of the Company Registrar under the Companies Act. A company that intends to trade also needs to register with the Department of Commerce.	Can issue different types of shares and debentures with limited liability to shareholder; and hence is an appropriate structure for equity investments, and can also raise capital from public markets.
Cooperative	Minimum of 25 members can register a Cooperative under the Cooperative Act.	Can issue shares and debentures and net profits are distributed to members after retaining 25%; however dividend cannot exceed 15% of the paid up capital per share. This is a less appropriate legal structure for equity investors expecting a market rate of return.

Source: Ministry of Industries

11.5.1 Comparable Valuation Multiples of Hotels from SAARC Countries

Table 26: Comparable Valuation Multiples of Tourism from SAARC Countries

Sub-Sector: Hotels and Resorts						
India						
Company	ROE %	D/E Ratio	P/E	EV/ EBITDA	EV/ Sales	Market Cap (in US $)
Hotel Leelaventure Limited	-50.3%	0.33	NA	9.93	1.4	126.9
Kamat Hotels	-35.6%	0.74	NA	5.54	1.24	22.2
TGB Banquets And Hotels Limited	1.8%	0.00	53.66	3.94	0.97	29.3
TAJGVK Hotels & Resorts Limited	0.0%	0.53	40.99	8.82	2.17	66.4
Viceroy Hotels Ltd.	-3.0%	9.65	NA	23.37	6.92	13.2
Asian Hotels (North)	6.3%	0.02	3.06	2.51	0.58	33.7
Asian Hotels (West)	-0.8%	2.23	NA	10.48	2.39	18.5

EIH Associated Hotels Ltd.	20.3%	0.16	15.9	5.81	1.8	60.1
UP Hotels Ltd.	6.6%	0.00	24.14	12.27	1.94	28
UP Hotels Ltd.	11.8%	0.25	10	5.88	1.71	15.5
Advani Hotels & Resorts	0.2%	0.15	44.83	16.02	3.49	21.7
Sinclairs Hotels Limited	14.4%	0.00	9.89	27.28	7.2	26.1
Royale Manor Hotels & Industries Ltd.	4.2%	0.93	6.37	3.82	0.9	1.72
Best Eastern Hotels Ltd.	5.4%	0.05	58.27	25.11	7.1	5.71
Gujarat Hotels Ltd.	16.5%	0.00	14.79	15.13	14.13	9.11
Sri Lanka						
Company	ROE %	D/E Ratio	P/E	EV/ EBITDA	EV/ Sales	Market Cap (in US $)
Aitken Spence Hotel Holdings PLC	16.9%	0.37	12.74	7.73	2.59	179.7
John Keells Hotels PLC	8.0%	0.57	15.75	11.66	2.91	139.2
Asian Hotels and Properties PLC	16.6%	0.01	11.03	9.4	3.48	217.3
Trans Asia Hotels PLC	18.9%	0.01	14.55	15.04	5.45	122.2
Tal Lanka Hotels PLC	-7.3%	0.34	17.07	11.9	2.53	29.7
Galadari Hotels	46.8%	0.07	NA	10.98	3.41	43.3
Serendib Hotels Plc	8.9%	0.36	10	6.91	2.44	21.3
Ceylon Hotels Corporation PLC	-2.7%	0.48	NA	15.39	3.25	20.1
Amaya Leisure PLC	14.8%	0.04	9.16	7.59	3.35	27.2
The Nuwara Eliya Hotels Company Plc	11.3%	0.00	9.3	7.25	3.07	19.9
Dolphin Hotels Plc	11.7%	0.40	6.94	7.22	2.42	10.9
Eden Hotel Lanka PLC	8.7%	0.01	7.01	5.2	1.87	11.7
Palm Garden Hotels PLC	-28.6%	1.42	NA	11.54	2.32	5.18
The Lighthouse Hotel PLC	3.6%	0.04	17.53	11.94	3.28	15.5
Royal Palms Beach Hotels PLC	5.6%	0.02	12.87	6.87	2.17	10.1

The Fortress Resorts PLC	18.8%	0.22	9.42	6.68	3.05	11.4
Mahaweli Reach Hotels PLC	1.2%	0.23	10.57	5.92	1.59	5.76
The Kandy Hotels Company	2.1%	0.00	28.55	18.13	7.26	31.4
Tangerine Beach Hotels PLC	4.5%	0.03	11.53	7.58	2.51	10.4
Pegasus Hotels of Ceylon	7.7%	0.02	7.29	5.72	2.09	8.16
Marawila Resorts PLC	-3.9%	0.97	27.71	16.9	4.07	4.96
Sigiriya Village Hotels PLC	9.7%	0.06	8.52	8.85	2.09	4.1
Hotel Sigiriya PLC	16.5%	0.01	6.36	5.2	1.72	3.4
Renuka City Hotels Plc	12.2%	0.02	6.91	3.75	2.08	13.4
Hunas Falls Hotels PLC	14.6%	0.02	11.75	8	1.86	2.01
Ramboda Falls PLC	8.5%	0.06	11.67	7.63	3.29	2.17
Indonesia						
Company	ROE %	D/E Ratio	P/E	EV/ EBITDA	EV/ Sales	Market Cap (in US $)
PT Panorama Sentrawisata Tbk	17.5%	1.34	11.23	5.62	0.29	38.4
PT Jakarta International Hotels & Development Tbk	57.1%	0.08	72.57	5.07	1.5	254
PT Pudjiadi & Sons Tbk	13.8%	0.09	11.15	4.56	1.46	37.9
PT Bukit Uluwatu Villa Tbk	5.5%	0.30	26.89	16.52	8.51	154.9
PT Hotel Sahid Jaya International TBK	1.2%	0.92	23.62	11.54	3.08	30.7
PT Indonesian Paradise Property Tbk	1.9%	1.06	92.74	14.42	4.72	43.4
PT. Pudjiadi Prestige Tbk.	7.4%	0.23	5.94	4.93	1.26	13
Mas Murni Indonesia PT	0.4%	0.94	39.5	9.13	2.29	9.48
PT Pembangunan Graha Lestari Indah Tbk	56.5%	0.08	230.77	18.58	2.71	6
Malaysia						
Company	ROE %	D/E Ratio	P/E	EV/ EBITDA	EV/ Sales	Market Cap (in US $)

Genting Berhad	15.5%	0.39	8.4	5.02	1.8	11572.7
Genting Malaysia Berhad	12.3%	0.08	16.54	9.23	2.76	7583.9
Berjaya Land Berhad	2.2%	0.80	117.78	9.58	1.47	1283.8
Berjaya Sports Toto Berhad	63.1%	0.18	12.8	9.78	1.59	1645
Magnum Berhad	7.2%	0.15	18.6	15.31	2.01	2066.8
Shangri-La Hotels Malaysia Bhd	8.0%	0.03	41.28	17.97	5.97	908.1
Berjaya Assets Berhad	2.0%	0.49	22.26	15.37	4.16	322.8
Reliance Pacific Bhd	0.6%	0.44	210.1	30.02	2.47	120.6
RGB International Bhd.	16.7%	0.61	17.68	3.23	0.89	38.9
The Nomad Group Bhd	1.7%	0.55	75.94	11.38	3.33	56.5
Grand Central Enterprises Bhd	4.1%	0.00	13.05	11.91	2.67	55.6
Pan Malaysia Holdings Bhd	-34.1%	0.30	NA	26.05	7.12	19.9
Bangladesh						
Company	ROE %	D/E Ratio	P/E	EV/ EBITDA	EV/ Sales	Market Cap (in US $)
Unique Hotel and Resorts Limited	4.4%	0.02	20.63	18.93	10.34	297.1
Pakistan						
Company	ROE %	D/E Ratio	P/E	EV/ EBITDA	EV/ Sales	Market Cap (in US $)
Pakistan Services Ltd.	1.8%	0.08	18.5	6.22	1.34	87.7

11.6 References and Field Research Data

The organisations interviewed during the course of this study have been listed in Table 27.

Table 27: List of primary interviews

Organisation	Sector
Government	
Nepal Tourism Board	Tourism

Organisation	Sector
Pokhara Tourism Board	Tourism
Industry associations	
Hotel Association Nepal	Hotel
Private Sector Organisations	
Fulbaari Clarks	Hotel- International
Kathmandu Guesthouse	Hotel- Domestic
Gokarna	Hotel- Domestic
Barahi	Hotel- Domestic
Himalayan Expedition	Adventure –trekking and tour operators
Eco Treks	Adventure –trekking and tour operators
Social tours	Non-mountaineering tours
Bawarchi	Restaurant
Himalayan Java	Restaurant

The references used in this study are as follows:

1. Meteorological Forecasting Division, Department of Hydrology and Meteorology, Government of Nepal
2. United Nations Development Programme's Human Development Report, 2013
3. World Bank Development Indicators database, accessed in May 2014
4. World Travel and Tourism Council; Travel and Tourism Economic Impact; 2014
5. World Travel and Tourism Council; Travel and Tourism Economic Impact; 2013
6. Government of Nepal, Nepal Tourism Statistics, 2012
7. Nepal Rastra Bank, Economic Activities Study, 2012-13
8. Ministry of Tourism; India Tourism Statistics; 2012
9. Asian Development Bank, The Rise of Asia's Middle Class, 2010
10. Nepal Business License e portal
11. Government of Nepal, Ministry of Tourism, Preliminary Statistics for 2013
12. Adventure travel trade organisation; Adventure tourism market report; 2010
13. Government of Nepal, Ministry of Tourism website, accessed in May 2014
14. Department of Industries, Industrial Statistics Reports 2005 – 2013
15. SEBON Annual report 2011-12
16. SEBI annual report 2012-13
17. Venture Intelligence India database, accessed in April 2014
18. India Private Equity Report 2013, Bain and Company
19. SECBD website, 2013

The survey questionnaires used in this study are as follows:

Tourism Companies Survey Questionnaire - Generic

Section A. Understanding private sector activity in tourism

1. Rank the following subsectors from 1 to 8 based on:
    a. Growth potential (with 1 having greatest growth potential and 8 least)
    b. Profit margins (with 1 having highest profit margins and 8 least)
    c. Organised activity (with 1 having most organised activity and 8 least)
    d. Competition from foreign firms (with 1 have most competition and 8 least)

Sub-Sectors	**Rank for Growth Potential (1-8)**	**Rank for profit margins (1-8)**	**Rank for organised activity (1-8)**	**Rank for competition (1-8)**
Hotels- 4&5 star				
Hotels- 3 star				
Hotels- Other				
F&B				
Travel & Tour Operators				
Tourism Related Transport Services				

2. Please select the approximate range of profit margins for companies in each of the following sub-sectors as per your assessment.

Sub-Sectors	**Less than 5%**	**5 to 10%**	**10 to 15%**	**15% to 20%**	**More than 20%**
Hotels- 4&5 star	☐	☐	☐	☐	☐
Hotels- 3 star	☐	☐	☐	☐	☐
Hotels- Other	☐	☐	☐	☐	☐
F&B	☐	☐	☐	☐	☐
Travel & Tour Operators	☐	☐	☐	☐	☐
Tourism Related Transport Services	☐	☐	☐	☐	☐

3. Please mention the approximate annual turnover, production capacity and utilisation of production capacity for companies operating in the following sub-sectors

Sub-Sectors	**Approx. annual turnover**	**Capacity Description**	**Capacity**	**% utilisation of capacity**
Hotels- 4&5 star		# of rooms and conference halls		
Hotels- 3 star		# of rooms and conference halls		
Hotels- Other		# of rooms and conference halls		
F&B		Seating capacity		
Travel & Tour Operators		-		
Tourism Related Transport Services		# of vehicles available		

4. How is the overall policy and regulatory environment? In what ways does it support growth of businesses and in what ways does it negatively impact growth. Please select any of the following that apply

Impact of regulation/policy	**Applies to tourism in Nepal (select all that apply)**

a) High upfront setup costs due to licenses	☐
b) Difficulty in acquiring land	☐
c) Competition with unorganised facilities in the market	☐
Any others? – Please explain	

Section B. Understanding Barriers to Growth of Private Tourism Companies

5. Rate the following challenges as “high”, “medium” or “low” based on the degree to which they act as barriers to growth (with “high” ranking indicating a critical growth barrier and “low” a less important growth barrier).

Challenges	**High**	**Medium**	**Low**
Access to Finance	☐	☐	☐
Access to markets	☐	☐	☐
Access to technology	☐	☐	☐
Access to talented employees	☐	☐	☐
Taxation	☐	☐	☐
Regulation	☐	☐	☐
Infrastructure: road, electricity, transport	☐	☐	☐
Corruption	☐	☐	☐
Any other challenges you would like to mention?			

Section C. Understanding access and use of capital

6. Which type of capital do tourism companies prefer and why? Please rate “high”, “medium”, and “low” (with “high” ranking indicating most preferred and “low” least preferred).

Capital Type	**High**	**Medium**	**Low**
Debt (bank loans, NBFC loans, venture debt)	☐	☐	☐
Domestic Equity (raising money from local investors by selling a stake in your company)	☐	☐	☐
Foreign Equity (raising money from international investors by selling a stake in your company)	☐	☐	☐

Why?

(Please explain your preference for debt/ domestic equity/ foreign equity briefly)

7. Which of the following do you see as the most important contribution by an equity investor? Please rate “high”, “medium”, and “low” (with “high” ranking indicating most important and “low” least important).

Contribution by equity investor	High	Medium	Low
Add expertise to your company	☐	☐	☐
Build new market linkages for your company	☐	☐	☐
Add financial value only	☐	☐	☐
Help to unlock capital for you by divesting or diluting company	☐	☐	☐
Help in accessing international growth opportunities	☐	☐	☐

8. Which of these following financing needs do tourism companies prefer to use debt for and which do they prefer to use equity for? Please tick in the appropriate column

Financing need	Prefer debt	Prefer equity	No Preference
Purchase fixed assets (land, building, furniture & fixtures)	☐	☐	☐
Extend to new markets	☐	☐	☐
Extend to new geographies	☐	☐	☐
Short term operational expenses (salaries, rent etc.)	☐	☐	☐

9. What is the growth rate that tourism companies can potentially achieve in the next 3-4 years? Please select any one of the following.

Growth Rates	Potential growth rates for tourism companies in next 3-4 years
10-15%	☐
15-20%	☐
More than 20%	☐

Tourism Companies Survey Questionnaire – Sub-sector Specific

3. Rate the [specific sub-sector] as “high”, “medium”, “low” for each of the following parameters

Parameters	High	Medium	Low	Comments (if any)
Growth potential	☐	☐	☐	
Profit margins	☐	☐	☐	
Organised activity	☐	☐	☐	
Competition from foreign firms	☐	☐	☐	
Demand from domestic market in Nepal	☐	☐	☐	
Demand from international markets	☐	☐	☐	

4. Please select the approximate range of profit margins for [specific sub-sector] companies as per your assessment

Less than 5%	5 to 10%	10 to 15%	15% to 20%	More than 20%
☐	☐	☐	☐	☐

3. Please mention the approximate annual turnover, production capacity and utilisation of production capacity for a typical company in [specific sub-sector]

Approx. annual turnover	Capacity	% utilisation of capacity

4. Please mention the top 3 companies in [specific sub-sector] by turnover and capacity? How many medium to large [specific sub-sector] companies operate in Nepal?

Top 3 Companies	
1)	
2)	
3)	
Approximate number of [specific sub-sector] companies in Nepal	

6. How is the overall policy and regulatory environment? In what ways does it support growth of businesses and in what ways does it negatively impact growth. Please select any of the following that apply

Impact of regulation/policy	Applies to [specific sub-sector] in Nepal (select all that apply)
a) High upfront setup costs due to licenses	☐
b) Difficulty in acquiring land	☐
c) Competition with unorganised substitutes in the market	☐
Any others? – Please explain	