EthiFinance

Hotel Sector: Characteristics and Outlook

Will the boom conditions of 2024 be repeated in 2025 ?

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As a European credit rating agency with a strong focus on the Spanish and French markets, EthiFinance Ratings has taken a keen interest in how 2024 proved to be another year of sustained growth for the tourism industry, continuing the upward trend seen since the pandemic. Indeed, tourism minister Jordi Hereu announced on 15 January that 94m tourists visited Spain last year, a 10% rise from 2023 and the highest annual figure since records began, solidifying Spain's position as the world's second-most visited destination, behind only France (which received over 100m visitors, a record for that country too).

What's Next?

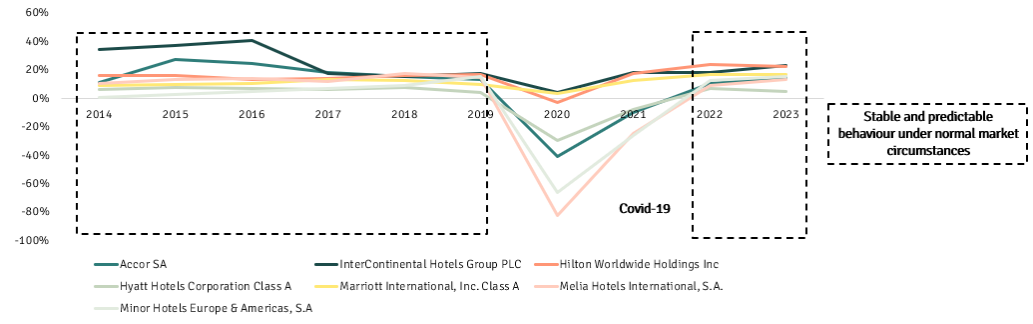
The key question is will 2024 mark a peak or will it go on to set fresh records in 2025? Before being able to answer that question it is necessary to assess the key characteristics of the hotel sector that EthiFinance Ratings uses to draw its analysis.

Profitability and Volatility Levels

The global hotel sector is highly fragmented, with over 500 hotel groups operating worldwide. However, a few well-established brands—such as Marriott, Hilton, IHG, Accor, Meliá, NH, or Hyatt—dominate the market, benefiting from their extensive geographic presence and strong brand recognition. At the other end of the scale, small operators are consolidating their position as alternative accommodations (mainly rural houses, hostels, lodges, and apartments), increasing competition within the industry.

Although profitability levels in the hotel sector vary significantly from one company to another, EthiFinance Ratings estimates the industry's average EBIT margin to be between 13% and 18%, with relatively low volatility. EBIT margins tend to remain stable and predictable under normal market conditions.

GRAPH 1: EBIT margin evolution - main hotel chains



Source: FactSet

Nevertheless, profitability is influenced by various factors, such as the target market, the location of the establishments, the accommodation category, distribution channels, and the management model adopted. In general, luxury hotels and major brands tend to achieve higher margins due to their stronger pricing power, whereas smaller independent hotels often operate with tighter margins.

To counter competitive pressures and achieve higher margins, major hotel groups have been implementing various strategies focused on offering higher value added and differentiated services. Expanding their portfolios into the luxury

segment, along with incorporating additional services—such as spas, gyms, fine dining, and personalized experiences—are key factors behind boosting profitability in an increasingly competitive market.

Additionally, a key focus is on optimizing processes through increased investment in technology, along with the growing need to adapt tourism offerings to reduce their environmental impact.

Barriers to Entry

The hotel sector presents multiple barriers to entry that make it difficult for new competitors to enter the market while favoring the consolidation of major players.

First, the initial investment can pose a significant challenge. The construction, acquisition, or renovation of hotel infrastructure requires substantial capital, not only for land and buildings but also for furnishings and advanced technology needed to remain competitive and operate efficiently. Additionally, the costs associated with complying with strict regulations and legal permits further raise entry barriers. While these requirements vary by country or region, they typically include operating licenses, safety standards, as well as environmental and labor regulations.

Second, brand positioning plays a crucial role in a sector where consumers tend to favor well-known brands due to their perceived quality, service consistency, and positive past experiences. Likewise, major hotel chains benefit from loyalty programs that help attract and retain frequent guests. Building brand recognition and customer loyalty requires significant time and effort, making it a considerable barrier in the way of new entrants in the industry.

The path to profitability is also filled with obstacles, especially for new entrants. Major hotel chains benefit from economies of scale, having built longstanding and privileged relationships with suppliers (furniture, food, beverages, etc.) and distributors (travel agencies, online booking platforms, among others). These relationships enable them to negotiate better terms and pricing. Additionally, new competitors often face low occupancy rates in their early stages. When combined with a less diversified portfolio—typically limited to urban or resort hotels—in a sector heavily influenced by seasonality, this can lead to significant initial losses and pose challenges to financial viability.

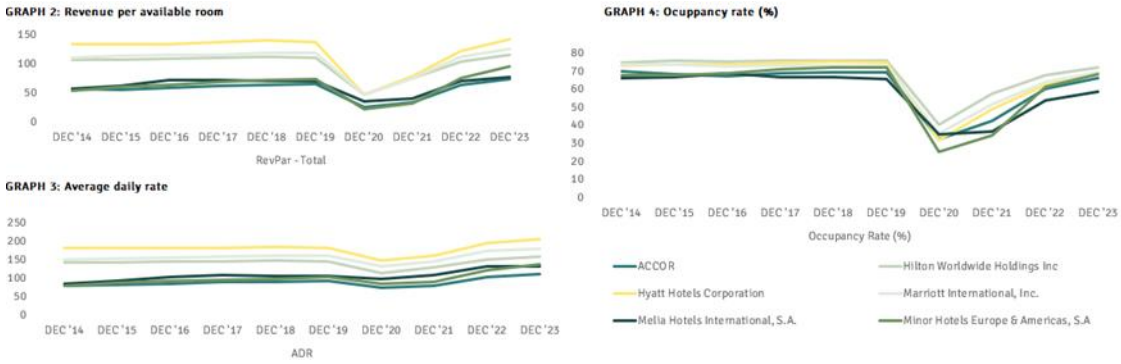
Finally, global crises—such as pandemics, economic recessions, or geopolitical conflicts—can have a significant impact on the hotel sector, as evidenced by the Covid-19 pandemic. Major players have more mechanisms and greater financial resilience (including access to market funding) to be able to navigate through these shocks, whereas new entrants face a higher financial risk.

In this context, the hotel sector remains a highly competitive and challenging market in which to develop a significant presence, where investment capacity, brand recognition, and efficient management are crucial to competing successfully.

Hotel sector outlook

The outlook for the hotel sector remains positive in our view, characterized by a sustainable balance between expansion and consolidation. However, EthiFinance Ratings anticipates a slight slowdown in the rate of growth, with more moderate increases in both the number of travelers and overnight stays (occupancy rates) than seen in 2024, as well as a greater stabilization in room rates (RevPAR and ADR).

This conclusion is based on the recent evolution of key hotel industry indicators, particularly among major chains, where pre-pandemic levels have already been surpassed in terms of RevPAR and ADR. However, the potential for further growth in occupancy rates is limited, suggesting that the full recovery to 2019 pre-pandemic levels is nearing its stabilization point.



Source: FactSet

Leisure travel will no doubt continue to drive the industry's volumes, particularly in vacation destinations, while business tourism is expected to maintain hybrid formats that blend in-person and virtual events. Sustainability, technological innovation, and personalized experiences will play an increasingly important role in the hotel sector, aligning with current global trends.

So, in answer to the original question, we expect more records for tourism in 2025, but with more moderate growth rates for the KPIs than seen in 2024, highlighting increasing capacity constraints.

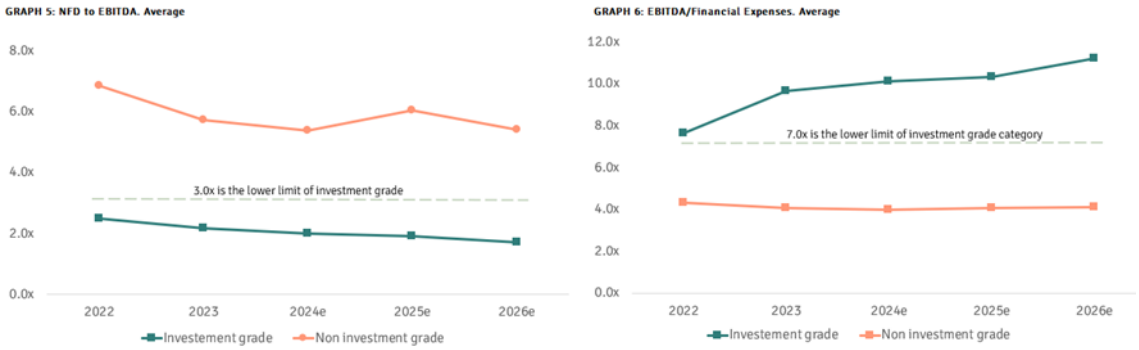
How Does This Reflect in Our Portfolio?

Beyond the differences in business profiles among the companies within our portfolio—which include leading Iberian and European hotel groups—including stronger brand recognition, broader diversification, and more professionalized corporate governance—as well as smaller family-owned businesses specializing in a single market segment, such as boutique, beachfront, or urban hotels—we would highlight the significant variations in financial metrics across these entities.

In 2024, the average leverage ratio for the companies under our analysis is estimated at approximately 6.0x for non-investment grade ratings and 2.0x for investment grade ratings. Meanwhile, interest coverage is expected to average around 4.0x for non-investment-grade ratings and 10.0x for investment grade ratings.

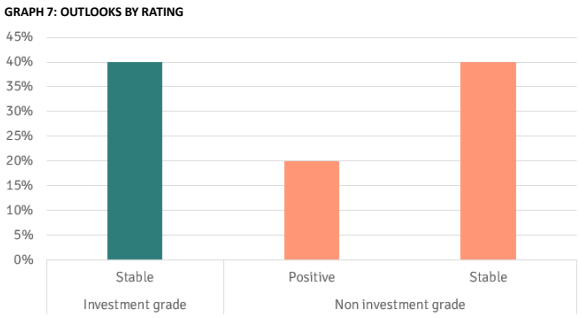
At EthiFinance Ratings, we expect the gradual normalization of financial conditions in the Eurozone to improve access to credit in 2025, facilitating the resumption of investment projects that have been on hold. As a result, by the end of 2025, we anticipate that the companies under analysis will exhibit a leverage ratio similar to or slightly higher than the 2024 estimate for non-investment grade ratings. Meanwhile, investment grade companies are expected to maintain a stronger financial position, with an average leverage ratio below 2.0x.

Regarding interest coverage, 2024 marked a turning point and the beginning of a normalization trend, which is expected to continue through 2025 and 2026. However, due to the lag between monetary policy adjustments and their impact on the real economy, we anticipate that debt costs will improve in 2025, although their effect on the interest coverage ratio will show a more gradual recovery.



Sources: Based on a sample of c.10 hotels, some of which are not directly rated by EthiFinance Ratings but have been added for benchmarking purposes.

For 2025, EthiFinance Ratings does not anticipate significant fluctuations in the corporate ratings portfolio for the hotel sector, with expected stability across both speculative and investment-grade categories (80% of the ratings have a Stable outlook).



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