

Vietnam is seeing significant new inventory enter the hospitality market. But unlike other segments of the real estate market, growth in demand remains strong and is increasing at double digit rates. The recent lack of capital inside Vietnam will slow future supply to a rate below the growth of tourists, lifting RevPar and values beginning in 2014. As China's middle class grows, Vietnam tourism will see exponential growth by the end of the decade. In ten years, Vietnam could be a top ten destination with international arrivals above 33 million people - 80% of which will be Chinese. We are seeing the bottom of the market, and now is a good buying opportunity for the right coastal real estate projects in Vietnam.

Ten Year Outlook for Coastal Tourism in Vietnam

Scenario Analysis by
MGT Management Consulting
March 2013

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Quantify Your Strategy

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*We can **never** make perfectly objective predictions. They will **always** be tainted by our subjective point of view.* – Nate Silver, *The Signal and the Noise*.

INTRODUCTION:

Recent interviews and online discussions about the potential of investing in Vietnam's tourism industry invariably turns to the supply of rooms coming onto the market, both in the last year and in the next year. Experts point to low occupancy at resorts in Danang and advise that occupancy rates will be low for the next year or two. Furthermore, supply has been predicted to increase at a faster rate than the rest of Asia. The market research firm Euromonitor International released a report that Vietnam's compound annual growth rate for hotels will be the highest in Asia between 2012 and 2016.¹

We think the worry about over-supply is over-stated. The high cost of capital within Vietnam (click [here](#) for our previous report on this) have left many planned resort sites undeveloped as of the first quarter of 2013. Sure, the over-supply of coastal rooms will put difficulties on resort owners for the next year², but for those contemplating Vietnam's coast as an investment opportunity, should it be a discouragement? As most financial advisors will tell you, if your investment horizon is one year, buy U.S. Government T-Bills. Resort investors need to have a ten year horizon at least. Perhaps now, while sentiment is as low as prices, it is the perfect buying opportunity. It is hard to know without some idea of what the next ten years will be like along Vietnam's tropical coast.

In our scenario analysis, we use our demand model, comparable development patterns of Mexico, and our instincts and experience to describe the future of coastal tourism in Vietnam. We'll highlight a few significant non-hospitality projects that if implemented, will make a substantial difference to some locations. We then consider how comparable international tourism locations developed, particularly Mexico, and to a lesser degree, Thailand and Bali. Using these examples, we analyze Vietnam's coastal locations and predict what type of destination they will become. Our focus is on the coast from Hue to the south. Locations further north have weather unfit for beach tourism during much of the winter, thus losing travelers trying to escape from their cold homeland.

¹ <http://english.thesaigontimes.vn/Home/business/tourism/26473/>

² <http://www.vietnamtravels.vn/tours/newsdetail/10916/Hotel-oversupply-anticipated.htm>

Our forecast model predicts 33 million international travelers visiting Vietnam by 2022, putting the country near the top ten countries for international arrivals¹. Nearly four out of every five of them will be Chinese. Many of them will be cross-border shoppers, but more than half will be vacationing on Vietnam's beaches.

Some of the predictions may seem impossible now, but looking back on the last ten years of beach tourism development in Vietnam gives a different perspective. Also, Vietnam is going to be in the center of an unprecedented growth in consumers, many who will travel internationally. If anything, our forecast could be too conservative. If you asked a fisherman (or hospitality expert) living on Cancun Island during the 1970's to predict the future of Cancun, six million visitors a year and 26,500 hotel rooms was probably not their answer. While we do not consider "Black Swan" events such as China starting a war with the rest of SE Asia, we are making a few bold predictions.

WORLD MACRO TRENDS:

Of course tourism in Vietnam will be influenced by worldwide trends. In general, we follow McKinsey & Company's vision of the future. Emerging markets, particularly China, are going to grow exponentially in importance while the developed economies of Europe and North America will have much slower growth rates. Previous MGT Management Reports ([here](#)) focused on the growing number of new Chinese consumers. McKinsey & Company forecasts 230 million **new** middle class Chinese consumers by the year 2020.³ They expect that between India and China, the two leading emerging economies will experience roughly 10 times the economic acceleration of the Industrial Revolution, on 100 times the scale. It will result in an economic force that is over 1,000 times more powerful.⁴

Our assumption is that Vietnam's economy lags China's growth by 2% per year, creating some separation in GDP per capita between the two countries. As incomes rise in China, more and more of the population become consumers. Consumer demand increases the cost of Chinese manufactured goods. Because it is cheaper, Vietnam supplies more and more of Chinese consumer goods, raising wages and living in Vietnam. China will invest more and more money into Vietnam's economy, even in the tourism sector.

³ http://www.mckinseyquarterly.com/Meet_the_Chinese_consumer_of_2020_2941#

⁴ http://www.mckinseyquarterly.com/Strategy/Globalization/Winning_the_30_trillion_decathlon_Going_for_gold_in_emerging_markets_3002

VIETNAM LAWS:

Three trends we are assuming concerning Vietnam Law:

1. *Continued progress towards land privatization* - It is becoming apparent where communism is going to land on the arc of history. We expect Vietnam's government to be stable but also continue its path towards more privatization. While the 2013 amendment to the land law takes steps in that direction, more can be done to protect those who are in possession of the land. With most the 20-year leases for farmland expiring this year, soon we'll have a good indication of how serious the government is. Most coastal resort land has 50-year Land Use Rights Certificates, which carries them well past the year 2022, so there still won't be any examples of what happens once the land lease expires on a resort. Our assumption of the worst-case scenario is that as long as the investment certificate is being followed, resorts will be allowed to renew their lease when it expires. Best case is resort developers are granted land use rights in perpetuity.
2. *Easing of foreign ownership restriction laws* - Another assumption is that Vietnam will begin allowing foreigners to have more ownership rights (transfer/sell their home) by the year 2022.
3. *Decreasing barriers for tourists* - We also feel Vietnam eventually follows the global trend of reducing the time and cost of visas for tourists.

Our assumptions about the Vietnam government may be too optimistic.

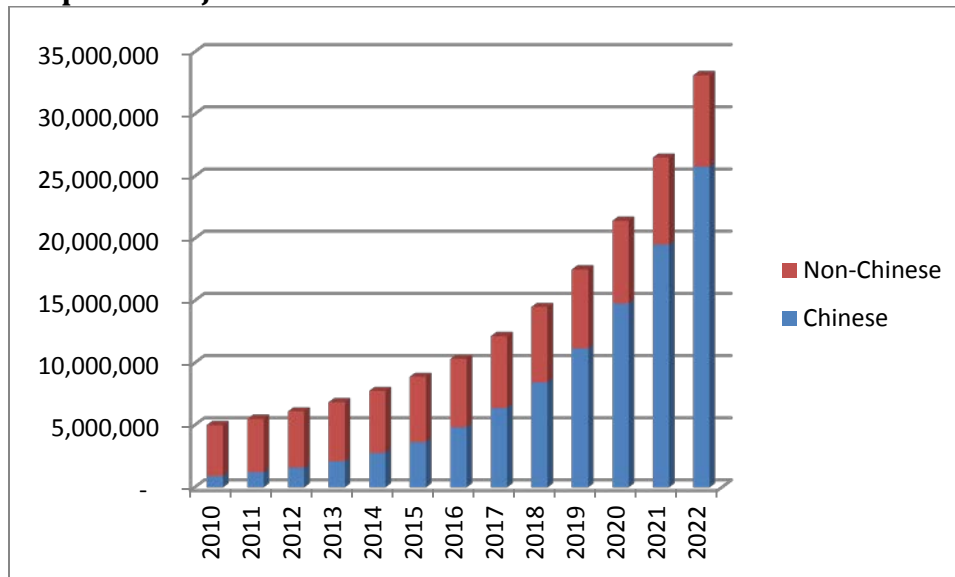
SUPPLY & DEMAND:

The rationale for our projection of international visitors to Vietnam can be found [here](#). To summarize, we used Mexico's tourism growth during the second half of the twentieth century as a comparable. A regression analysis studyⁱⁱ from that time identified variables which explained 95% of the year-to-year variance. We incorporated their results into our model to determine international arrivals for the next 10 years.

Demand

Graph 1 shows our forecast of international arrivals to Vietnam over the next ten years. Obviously we are assuming small, consistent growth in non-Chinese arrivals, and exponential growth in the number of Chinese. If China's economy slows below 7.5% growth for a significant amount of this time, it will have a severe effect on our numbers. We also assume that the income gap between China and Vietnam widens in China's favor, thus giving them more purchasing power in Vietnam than their own home.

Graph 1: Projected International Arrivals to Vietnam



Vietnam's General Development Office has set a goal of 10.5 million tourists by 2020 and 18 million by 2030⁵, much lower than our forecast. Their numbers might be only tourists, while ours includes business visitors and cross-border tourism. However, even with these differences, our forecast is much more aggressive. We believe growth will be exponential, mirroring the exponential growth of the middle class in China.

Two major caveats to this graph. The first is that this is a prediction of demand. If Vietnam's coastline is not developed with enough appropriate rooms or the infrastructure cannot handle these high numbers, the tourists will go to other countries in the region. The second is that this may be too conservative. The tens of millions of new Indian middle class consumers are not projected to be significant to Vietnamese tourism in our model.

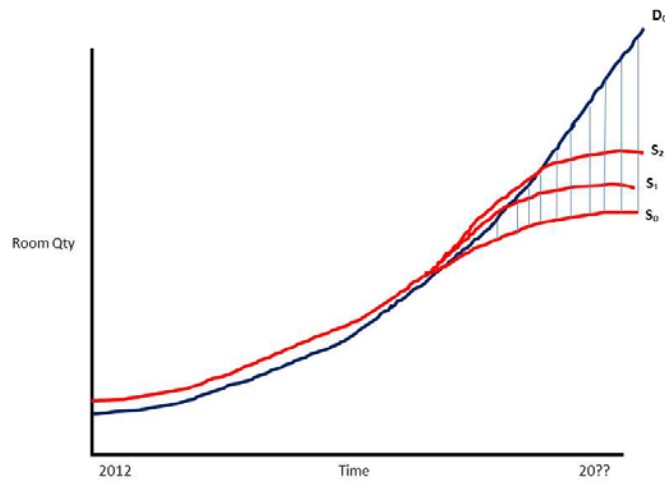
Supply

The total supply of beach land is constrained, particularly the amount of good beach land near an international airport. Despite being a long country with over 3,000 kilometers of coast, it has only one-third the amount of coastline as Mexico. Also, Mexico's entire coastline has year-round hot temperatures while only two-thirds of Vietnam's has ten months of beach weather. In addition to warm winter weather, a competitive advantage of Vietnam for Chinese tourists is travel time, so resorts that are faster and easier to reach will have much higher value than resorts that add travel time.

In the Graph 2, three different supply curves represent the supply of rooms with characteristics most demanded by Chinese and other tourists. ⁱⁱⁱ

⁵ http://ven.vn/tourism-expected-to-account-for-75-percent-of-gdp_t77c499n34766tn.aspx

Graph 2: Vietnam's Hotel Room Supply and Demand Growth



During 2009-2011, the Vietnam Central Bank added large amounts of money to the country's economy in response to the world-wide financial crises. Among other things, this resulted in a considerable amount of hospitality rooms opening in 2012 and 2013. The new supply resulted in average revenue per room rates (RevPar) dropping.

The recent lack of available capital in Vietnam will have the opposite effect beginning in 2014. In the last two years, many planned resort projects have been delayed or cancelled due to high costs of capital or no capital at all. With international arrivals still growing above 10% per year, RevPar will begin to increase. By 2016, we expect to see demand exceed supply. It is during this time that resorts will generate higher than average rates of return. Suppliers on all three curves will benefit from surplus demand, but owners of better locations will of course, benefit the most and the soonest.

Table 1 uses Mexico (in 1990) as a comparable to Vietnam. Vietnam has about the same number of 3 to 5-star rooms per international arrival as Mexico had back in 1990. Based on our demand forecast, Vietnam will need a 15.5% year-on-year growth rate (or 13,100 rooms per year for 10 years) in 3,4 and 5 star rooms for the next 10 years, to maintain this ratio. Euromonitor International forecasts 15% year-on-year growth from 2012 to 2016⁶, although that forecast was probably made before the banking crisis in Vietnam slowed development.

⁶ <http://english.thesaigontimes.vn/Home/business/tourism/26473/>

Table 1: Vietnam / Mexico Comparison⁷

Country / year	Quantity of 3 to 5-star Rooms	International Arrivals	Intl. Arrivals Per Room
Mexico / 1990	82,000	15,757,000	192
Vietnam / 2012	40,800 ^{iv}	7,800,000	191
Vietnam / 2022	172,000*	33,123,000 ^v	192

** Using MGT's forecast for international arrivals,^{vi} this is the amount of rooms needed by 2022 to match Mexico's ratio.*

As we mentioned, new supply will slow for the next two years. What happens after 2015 depends on how fast the real estate/banking crisis ends. If the cost of capital remains high, we may see demand overtaking supply, causing asset prices and RevPar's to increase even more. We anticipate Chinese hospitality companies to begin buying Vietnamese resorts in great numbers at this stage.

Of course Mexico's past and Vietnam's future are not perfectly comparable. Issues that must be considered are:

1. *The amount of hotel rooms include non-coastal hotels* – True. But the size of Saigon and Hanoi combined are is not that different than Mexico City in 1990, and there are several other similarities that make the countries comparable.
2. *Mexico did not have a competitor like Thailand, adjacent to it* - Mexico did compete with Caribbean countries, but during this time period social unrest and high crime rates made Mexico the logical choice. We feel that if the facilities are built, Vietnam has several competitive advantages over Thailand including being closer, cheaper, and more familiar to the new middle class consumer.
3. *The Chinese middle-class will behave/spend differently than the new American middle-class did* – Yes, many of them will behave differently, but even niche markets of Chinese middle class consumers will be massive. The number of new Chinese middle class consumers from 2012 to 2020 will outnumber American middle class growth from 1947 to 1979 by more than three to one.

⁷ *Mexican Tourism: Export Growth and Structural Change since 1970*, Michael Clancy. *Latin America Research Review*, Vol 36, number 1. 2001.

INFRASTRUCTURE & DEVELOPMENT:

New infrastructure projects are going to change coastal tourism in Vietnam over the next decade. Some projects will help localities; others will eliminate coastal locations from the tourism map.

Airports

Currently, four airports in Central/South Vietnam receive international flights. Danang's international airport, the 3rd busiest in Vietnam, was just upgraded and expanded. It has already begun receiving flights from South Korea, China, Singapore, and Malaysia. Phu Quoc Island just recently opened a new international airport, too. We are not predicting any significant changes to either, as both have capacities of 4 and 7 million passengers per year, respectively.

The Cam Ranh International Airport will be significantly improved in the next ten years. Currently it receives ten direct flights a week from Russia and a few from South Korea. Its current capacity falls short of demand and the government plans to expand the terminals and the number of runways to allow the airport to receive 5.5 million passengers by 2020 and by 2030 it will have enough room at the terminal to receive 8 million passengers and park 36 aircraft at once.⁸

Another big change will be in Ho Chi Minh City, where the new Long Thanh Airport is scheduled to open in 2020. It is located 40 km north of the city and is expected to become a regional hub with a capacity of 25 million people, replacing the current airport in HCMC for international flights. More than likely it will not be finished in the next 10 years, but the anticipation of the new airport will stimulate development along the coast just northeast of the city.

Our assumptions are that Qui Nhon, Con Dao, Tuy Hoa (Phu Yen), and Phu Bai (Hue) airports will remain domestic only. As Danang's airport reaches capacity during summer months, we expect plans to be in place for Phu Bai Airport in Hue to be upgraded by the end this decade.

⁸ <http://www.vneconomynews.com/2011/08/foreign-investors-eye-cam-ranh-airport.html>



Vietnam Coastal Airports (Central/South)

Railway Upgrades

North/South - The most important improvement the Vietnam Government can make for coastal tourism is to upgrade the passenger rail system. Vietnam's north/south railroad is over 50 years old. The few tracks have so much traffic that trains constantly need to wait at certain locations for another to pass in the opposite direction. The cars themselves are disgusting and decrepit. It is a national embarrassment and hopefully will be fixed soon.

The Vietnam government is considering several different plans for upgrading. It recently rejected an expensive high-speed option that would make travel time from Saigon to Hanoi less than seven hours (from 28 hours). A much more likely scenario in the next ten years is small improvements to the main line while developing a high speed route from Saigon to Nha Trang⁹. If this happens, travel times from Saigon to Nha Trang would be equivalent to the time it currently takes to travel from Saigon to Vung Tau.

East/West – In 1938, the French built a railway from the coastal city of Phan Rang to the mountain city of Dalat. However, it was closed in 1968 due to the war. Restoration of the railway is a priority for both the Ninh Thuan and Lam Dong (Dalat) Provinces and has the backing of the central government.¹⁰ When opened, it

⁹ <http://www.tuoiitrenews.vn/cmlink/tuoiitrenews/society/jica-proposes-1-8-bln-upgrade-on-north-south-railway-1.83274>

¹⁰ <https://www.facebook.com/pages/Da-LatThap-Cham-Railway/117588428293516#>

will connect the popular mountain tourist destination of Dalat with the north/south railway, at the beach city of Phan Rang. Currently over 47,000 tourists take the short 7 km train trip that has already been restored near Dalat¹¹. Five kilometers from Phan Rang is one of the nine most beautiful beaches in Vietnam, called Ninh Chu Bay.



Phan Rang and Dalat

Cruise Ship Ports

Vietnam has tremendous potential as a cruise ship destination, but as of yet the country has no coordinated cruise ship policy or dedicated docks. In 2012, only 285,000 international tourists arrived by cruise ship. While that amount is six times more than in 2010, it is actually less than the number of sea arrivals in the year 2000! The government has set a target of one million by 2015.¹²

By 2022, we expect some improvement. We predict three major ports-of-demarcation in the central and south part of the country; Phu Quoc Island, Cam Ranh Bay, and Danang. The new larger ships cannot reach HCMC because of the Phu My Hung Bridge. Cam Ranh will be chosen over Nha Trang because the Khanh Hoa Provincial Government allowed Vinpearl resort to build a tram across the bay that is too low for large ships to pass under.¹³ Vung Tau will be eliminated for reasons we mention below.

¹¹ <http://www.dulichninhbinh.com.vn/en/ninhbinh-news/Investment-needed-to-restore-historical-Da-Lat-cog-railway.html>

¹² <http://english.vietnamnet.vn/fms/travel/56263/cruise-tourism-grows-well-but-still-lags-decade-ago-number.html>

¹³ <http://www.vir.com.vn/news/business/vietnam-urged-to-better-develop-sea-tourism.html>

Highways

An upgrade of Highway 1, the main north/south highway is desperately needed. In ten years' time, major sections will most likely have been finished. It will make Phan Thiet more accessible from Saigon, but not by much. As we have seen with the upgrade of Highway 51, which runs from Saigon to Vung Tau, the benefit of the upgrade is quickly countered by the increased traffic flow that gravitates towards the better route.

Mining and Energy

As natural resources become scarcer, Vietnam, like most countries, will be willing to sacrifice the environment and tourism. Oil drilling off the coast of Vietnam may cause environmental damage to the beaches. Vung Tau is already polluted. A large oil refinery off the coast of Phu Yen is planned to begin commercial operations in 2016¹⁴.

The recent discovery of huge titanium deposits in the south central province of Binh Thuan will have an adverse effect on tourism near Mui Ne within the next ten years. The Binh Thuan government is already delaying over 100 tourism projects in the province because it is unclear whether to allow mining or resort development. According to Vietnam's mineral law, the underground titanium must be extracted before any architectural structures are allowed. There is an estimated 520 million tons in the 1,250 square kilometer area. World usage is only 17 million tons per year, meaning some of the titanium would not be mined within 50 years.¹⁵

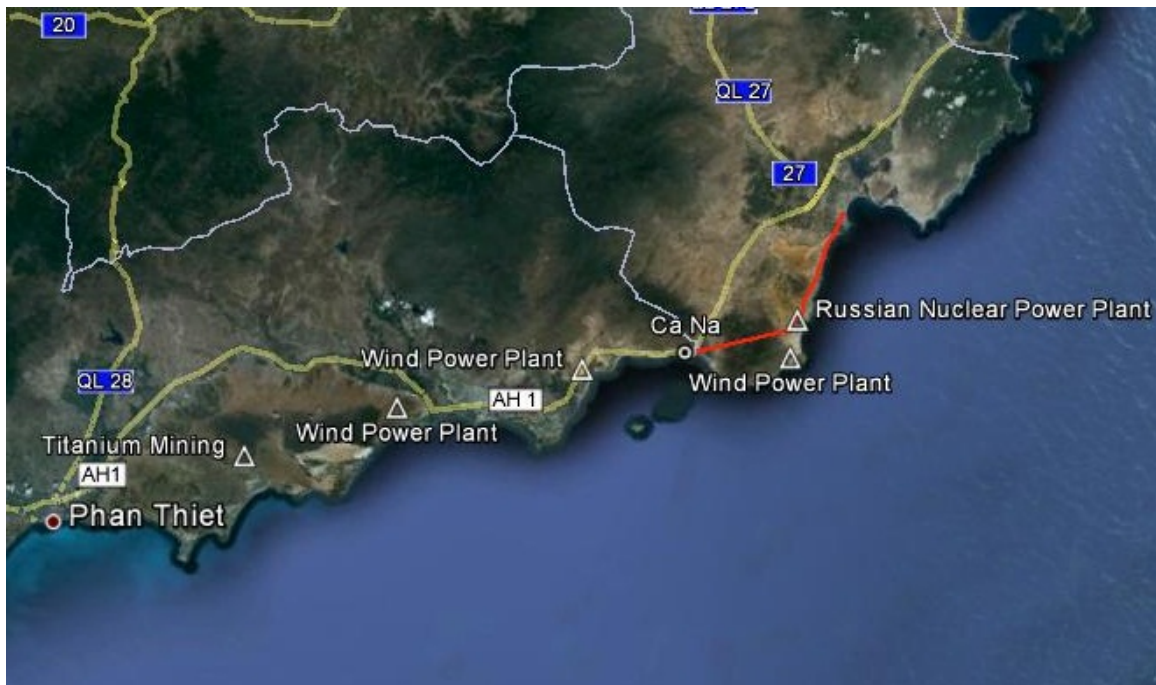


Example of a titanium mine near the beach

¹⁴ <http://www.vir.com.vn/news/coverage/refinery-enjoys-breakthrough.html>

¹⁵ <http://english.vietnamnet.vn/fms/travel/58306/titanium-mining-upsets-tourism--wind-power-projects.html>

We project a large amount of coastline in the south (between Phan Thiet and CaNa) is going to be allocated to energy and mining production. This area will be the location of Vietnam's first nuclear power plant. Also, many different wind power projects on the south central coast are scheduled to begin construction in the next few years. CaNa, a small fishing village in southern Ninh Thuan Province has the potential to be an important shipping port. It has a great bay and is directly on the path of Highway 1 and the railroad.

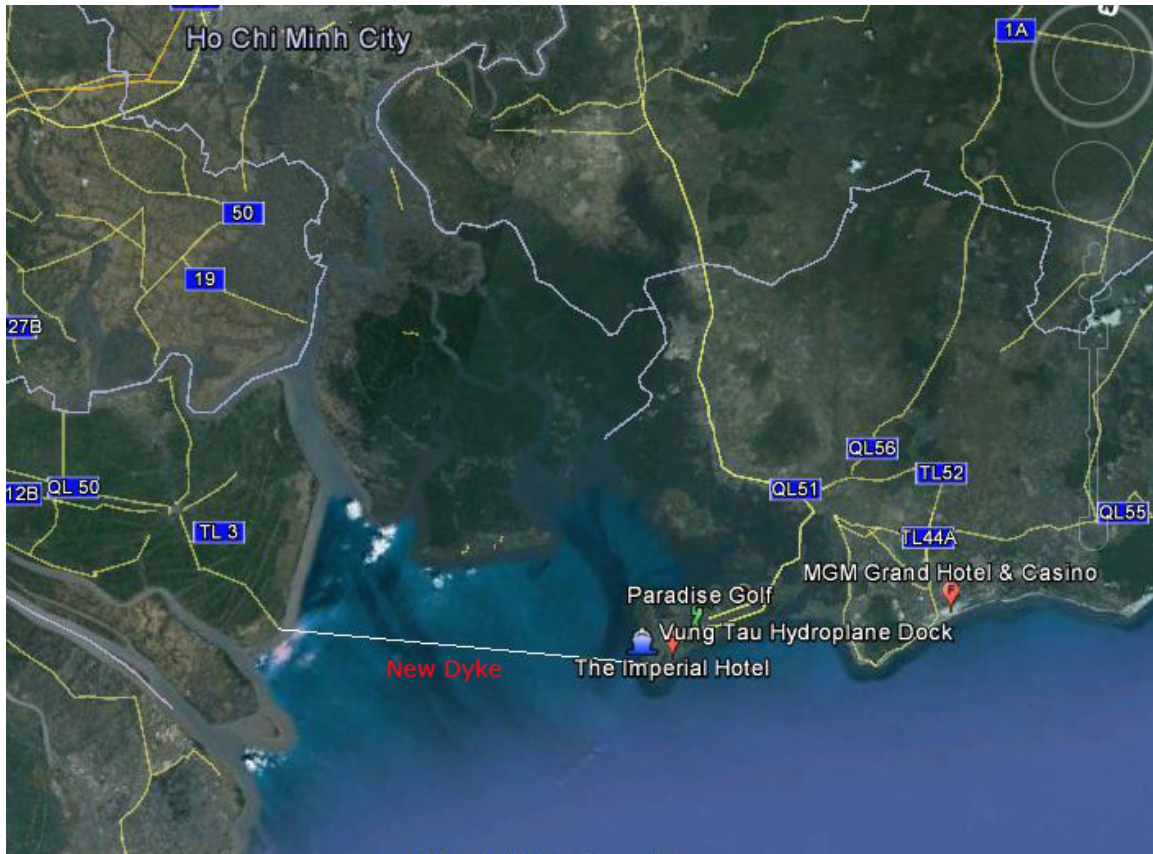


Non-hospitality development in northern Binh Thuan Province

Flood Control

Saigon already has flooding problems caused by heavy rains and high ocean tides pushing the Saigon River back up into the city. Fears that global warming will cause oceans to rise and worsen this situation has the Vietnam Government looking for solutions to the problem. Building a sea dyke in Vung Tau Bay that can be opened to let water out when the tide is receding, but to keep ocean waters from entering the bay when the tide rises is one solution being considered. The building of this dyke will make Front Beach of Vung Tau a polluted lagoon and nearby beach property much less valuable. Environmentalists deplore the idea¹⁶, but given the option of destroying Vung Tau's ecology or Saigon being underwater six months a year, we think the Vietnam government will definitely choose the former.

¹⁶ <http://vietnamnews.vnagency.com.vn/Environment/222312/experts-warn-against-sea-dyke-proposal.html>



Position of the proposed sea dyke in Vung Tau

Military

Another important development in the next ten years would be if Vietnam allowed a U.S. naval base in Cam Ranh Bay. Escalating tensions with China regarding the islands east of Danang may be the impetus. Already, non-military U.S. ships are allowed into the port for repairs and U.S. Defense Secretary General Panetta just visited the bay in 2012.¹⁷

INTERNATIONAL TOURIST RESORT DESTINATIONS:

With so many similarities to Mexico¹⁸, Vietnam's international tourist resort destinations are likely to grow analogously. It took four decades for three generations of resort destinations to become established in Mexico¹⁹. Because the model has been formed,^{vii} the time it takes for Vietnam to go through this evolution will be compressed. Before discussing locations in Vietnam, it is important to understand the progression of resort destinations.

¹⁷ <http://tuoitrenews.vn/cmlink/tuoiitrenews/politics/pentagon-chief-visits-cam-ranh-bay-1.74562>

¹⁸ http://www.mgtmanagement.com/uploads/Vietnam_Coastal_Tourism-Part_I_Look_to_Mexico.pdf

¹⁹ This section relies heavily on the article, *Three Generations of International Tourist Resorts in Mexico* by Jeffrey S. Smith. Published in *Geographische Rundschau International Edition*, Vol 5, No 1/2009

1st Generation Resort Destinations

First generation tourist destinations are typically former fishing villages with warm climates and sandy beaches. Adventure travelers discover the location and spread the word, leading to an infusion of money from new tourists. Local investors (and expats) develop businesses to service the tourists. The speed of the conversion from fishing to tourism typically catches the local government by surprise and the infrastructure and regulations never catch up. This usually creates environmental degradation, intense overcrowding, inadequate housing, and poor infrastructure.

The 1st generation resort destinations usually remain 1st generation and the vacationers are typically low-spenders. However, if demand is greater than supply and the local governments catch up with infrastructure, 1st generation resorts can eventually be upgraded into 2nd or 3rd generation resorts. This typically happens after good alternative locations come off the market^{viii}.

2nd Generation Resort Destinations

Mexico's 2nd generation resorts were the government's solution to the 1st generation problems. The government planned every detail of communities like Cancun, both for the locals and the resort owners. The government even helped finance resort projects by guaranteeing loans with money from oil exports. The result was over 26,560 rooms servicing over 6 million visitors each year in Cancun alone. Second generation resorts typically are gated, all inclusive destinations designed to keep the tourists in and the locals out.

We don't believe Vietnam will ever have enough of a coordinated effort to plan mega resort destinations such as those in Mexico, but local governments in Danang, for example, have worked closely with resort developers to provide needed infrastructure. Other places such as Phu Quoc have had terrible coordination with developers.

Second generation resort are typically designed for middle class to upper middle class tourists. Some target the higher end of the market as well.

3rd Generation Resort Destinations

The new generation of international resorts share two characteristics. First, they are a reaction to the 2nd generation, meaning they are not "cookie cutter" resorts trying to keep local culture out. The resorts are integrated into the surrounding community. Second is that they cater to either to highly affluent travelers or highly specific niche customers (e.g. high-end adventure travelers).

In Mexico, each generation was a reaction to the previous. Mistakes were corrected. Vietnam's late arrival to beach tourism allows it to learn from the mistakes of others. The three generation of resorts are being developed concurrently, rather than linearly.

Southern Beaches Near Saigon

The 1st generation beach resort destinations Vung Tau and the Phan Thiet/Mui Ne will probably not change significantly in the next ten years. Despite being first, the two beach areas still have no major international hotel brands.^{ix}

Front beach of Vung Tau may become a lagoon, and the beaches on the backside of the peninsula are not private. Locals stay in cheap mini-hotels and flock to the beaches during the day. No one has enough incentive to keep the beaches clean and orderly.



Back Beach of Vung Tau (taken March, 2013)

Being very close to Saigon will make it an affordable location for 2nd homes and apartments, mostly for Vietnamese.

Phan Thiet/Mui Ne is another 1st generation resort destination that has filled with locally owned and managed resorts. Its competitive advantage to other locations is the distance to Saigon, making it cheap (but not fast) to arrive. If, by the end of this decade hospitality demand far exceeds supply in Vietnam, the locally owned resorts near Phan Thiet might be purchased by the large international brands or Chinese investors and then converted into 2nd generation resorts. This is happening in Acapulco, Mexico. Progress on the new Long Thanh Airport will significantly increase the chances. Improvements in railway or highways would do the same. As we mentioned above, the large titanium reserves has put expansion north of Mui Ne on hold. Even if the government allows tourism development on that land, a developer would experience significant uncertainty as any increase in titanium prices may lead to the land be reclaimed by the government. Our prediction is that the coast from Mui Ne north to CaNa and Mui Dinh will not be developed for hospitality because of large mining and energy projects.

Currently Phan Thiet/Mui Ne is very popular with Russian tourists. The area is warm and dry during the winter months. However, as the 2nd generation resorts open in Cam Ranh and Ninh Thuan, we expect the families and wealthier Russians to remain near the airport. Already, more Russians fly into Cam Ranh International Airport than any other airport in Vietnam. Phan Thiet is a five hour drive and Cam Ranh Beach is a five minute drive.

In between Vung Tau and Phan Thiet lie Ho Tram and La Gi. This stretch of coast avoided being developed as a 1st generation destination because Highway 1 passes to the east. With ~~MGM Grand~~ *Casino to be named later* and Pinnacle developing casino resorts and Asian Coastal Development still having plans for three others, this area is destined to be a new 2nd generation area. Obviously the development of casinos means this stretch will become a primary destination for Chinese middle class and upper middle class. Fast and cheap to reach, and cheaper once they arrive, the Ho Tram Strip will have some significant competitive advantages compared to other SE Asian casino destinations.^x

In addition to the resorts, this area may be the preferred location for 2nd homes in Vietnam by 2022. It will be relatively close to the new Long Thanh Airport, and also to Saigon. With gambling nearby, it may see heavy investment by wealthier Chinese looking for vacation homes in a year-round warm climate. Wealthier Saigon residents may also choose this area for second homes just like many from Hanoi purchased places in Danang. The best comparable might be Hua Hin in Thailand.



Ho Tram and La Gi

Danang/Hoi An/Hue

Already the heart of coastal tourism in Vietnam, the central resort locations of Danang, Hoi An, and Hue will see an additional 1,500 4-5 star rooms come onto the market in 2013. This is on top of the 7,000 new rooms that came on the market the previous three years.²⁰ Coastal development is spreading north, south, west and up.

²⁰ www.m.english.vietnamnet.vn/fms/travel/68172/central-region-feels-uneasy-about-tourism-industry-in-2013.html

Many new internationally branded high-rise hotels are in the process of opening along with the beach resorts. While some analysts are concerned about over supply, we think the area will continue to develop as it has, with more resorts and hotel opening on the Son Tra Peninsula and the beaches between Danang and Hue. The beaches south of Hoi An will eventually be developed (2017 or later) to meet demand, but the area north of Hue becomes too wet and cold for much of the year.



Danang / Hoi An / Hue

These destinations are going to see the greatest impact of the new Chinese middle class tourists. It is the closest coastal location with ten months of warm temperatures. We expect large numbers of Japanese and Koreans to discover the beaches and the reasonable costs. Occupancy at resorts is low during the winter, but at least the area has cultural tourism to alleviate the loss of beach vacationers during December and January.

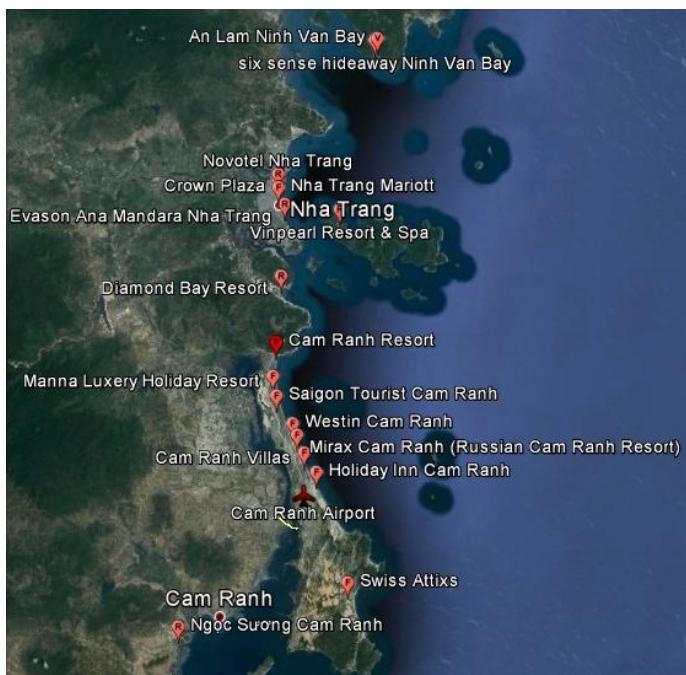
Improving the road between Danang and Hue will be important in order to maximize the appeal of this area. Currently it takes too long for tourists to visit the UNESCO World Heritage sites of Hue from Hoi An, and vice versa. Also, the provincial government of Quang Nam will need to avoid the temptation of allowing modern development to intrude on Hoi An. The popular location's competitive advantage comes from the colonial French architecture and "old world charm". So far they have shown a good understanding, but we would feel better if the three separate governments in this area coordinated their tourism efforts to leverage each other's attractions rather than try and compete for tourists and development dollars.

Nha Trang

Nha Trang Bay and the city itself are very different from the other coastal locations in Vietnam. The beach between the road and the ocean is public or will become public soon. On the other side of the road, the city is expanding upwards. Several high-rise hotels managed by Sheraton, Novotel, Marriott, Yasaka, and Crown Plaza are already opened (or opening soon). Other tall residential condo buildings have also recently launched. In order to provide enough beach access for those staying in these buildings, the provincial government is moving all resorts out of the bay. This should provide enough public beaches for further high-rise hotel developments by 2022. New projects will replace the 2-star hotels which are within a few blocks of the beach.

Resorts will be built to the north, south, and nearby islands. Some resorts have already opened, like An Lam Ninh Van Bay which can be considered 3rd generation. Larger, 2nd generation resorts will be developed closer to the airport, on the Cam Ranh Peninsula and Ninh Chu Bay to the south.

Nha Trang will continue to grow and receive a diverse group of tourists. It is large enough to have something for everyone. A United States Naval Base in Cam Ranh may have a huge effect on the area. If it is approved, Nha Trang could become a wild bar and nightspot destination rather than a beach resort destination. However, with lots of beaches nearby, Nha Trang will definitely be the hub of south central beach tourism. During winter months it will surpass Danang/Hoi An as the number one beach location. Because of the weather, Nha Trang is much better suited for repeat visitors who are interested in the beach rather than heritage, so over time it may supplant the central coast as top spot year round.



Some existing and planned resorts in Khanh Hoa (names may have changed)

Cam Ranh Peninsula

With long stretches of beautiful beaches, great weather all year, and no cultural activities anywhere near it, Cam Ranh's long beach is perfect for 2nd generation resorts. Already the stretch of land five minutes from the airport has been parceled out into large, homogeneous plots reserved for international resort management companies. The southern end of the peninsula will also eventually have beach resorts. A Swiss-Vietnamese partnership with United Arab Emirates money recently announced it will develop large resorts in the near future, there.²¹

Many resorts on this peninsula have broken ground, but most have been delayed since doing so. By 2015 this stretch of beach will look much like Danang looked in 2012. Airport upgrades scheduled to be finished by 2020 will be needed for Cam Ranh to expand much past that level, but by 2022 we expect Cam Ranh to be a favorite winter destination for Chinese, Japanese, Korean, and Russian middle class travelers. It will be a popular cruise ship port as well.

Northern Ninh Thuan Province

Northern Ninh Thuan Province, located just south of the Cam Ranh International Airport, has the advantage of not being developed early like Nha Trang, Phan Thiet/Mui Ne, and Vung Tau. The geography is more diverse than Cam Ranh and the beaches are backed by a large national park (Nui Chua) ensuring very natural and peaceful surroundings. In short, this area is perfect for 3rd generation resorts that incorporate the local environment with luxurious accommodations. It also has the advantage of being near an international airport and a large urban center, unlike other undeveloped locations. Despite being close to the international airport, the beaches were previous inaccessible. Now a beautiful new highway runs from the airport along the coast. Vietnam's first truly 3rd generation resort is about to open here, the Aman Resort Vinh Hy Bay.



Northern Ninh Thuan Province

²¹ [http://www.vir.com.vn/news/travel/khanh-hoa-tourism-gets-\\$200-million-shot.html](http://www.vir.com.vn/news/travel/khanh-hoa-tourism-gets-$200-million-shot.html)

A little further south is beautiful Ninh Chu Bay in Phan Rang. Phan Rang is the capital of the province, has a population of over 200,000, and is the driest city in Vietnam. If the Dalat to Phan Rang railroad is re-opened as planned, Phan Rang will become the tourist gateway to the south central highlands. We expect Ninh Chu Bay to become a popular stop for tourists traveling up and down the coast, as they take side trips into the mountains. Ninh Chu Bay currently has seven resorts open and several more in process, but they are all Vietnamese owned and operated. By 2022, we expect the northern Ninh Thuan coast to be filled with a diverse selection of internationally branded resorts, with several of them being the 3rd generation type focusing on niche markets.

Quy Nhon/Phu Yen

Speculators and developers have had their eye on the central coast, between Hoi An and Nha Trang for a few years, now. Several management agreements were even signed with international hospitality management companies like Ritz-Carlton, JW Marriott, Movenpick and Outrigger. Not much has actually been started and the provincial governments are getting impatient. Because of the long driving/train distance from both Saigon and Hanoi and only small local airports, this stretch of coast figures to be developed last among the locations south of Hue. Resorts here will have to be 3rd generation resorts targeting niche markets in order to offer anything that cannot be found closer to an airport or large city. With the great number of Chinese visiting Vietnam, travelers from other countries may look to these places as a way to escape the crowds.

By 2020, we expect enough demand to initiate the planning of a larger international airport between Tuy Hoa and Quy Nhon.

Southern Islands

Perhaps the most difficult region in Vietnam to predict, Phu Quoc Island could either be the next Phuket or the next Vung Tau in ten years. International developers such as the Millenium Group (HK) and Trustee Suisse have huge tracts of land allocated to them to build multiple large 2nd generation style resorts with golf courses. However, delays with land clearance and the provincial government's ineffectiveness have kept these developers from beginning for several years. During this time, Vietnam land speculators were purchasing the rest of the land in anticipation of increased prices from foreign demand once the international airport opened. This dual effect has kept the island from being developed properly. The problem is so bad that the Kien Giang Provincial People's Committee has begun revoking investment licenses of 54 projects with another 41 projects put on notice to begin or lose the land.²² The government also has set a minimum investment amount per bed and now requires a 5% deposit that is not refunded if the developer falls behind.²³ To make matters even more confusing, recently Vietnam's Central

²² www.yourviet.blogspot.com/2012/10/vietnam-phu-quoc-scraps-delayed-projects.html

²³ www.m.english.vietnamnet.vn/fms/travel/57497/island-requires-vnd1-1-bil--bed-for-five-star-hotels.html

Government made the unprecedented move of controlling the island's development from Hanoi rather than the provincial capital.²⁴ Throw in a banking crisis that has reduced available capital and inflated the cost of money and there is considerable questions as to whether the new international airport will ever get close to capacity.

The Mexican Government had similar issues in the early 1970's when trying to develop Cancun Island into an international resort destination. Investors were cautious about being the first in a new location. The Mexican Government solved the problem by establishing state owned and managed resorts while also guaranteeing the financing of private resorts.²⁵ We are not predicting this will happen in Phu Quoc^{xi}. We do think other SE Asian resort destinations like Bali and Phuket will reach capacity limits (either land or airport), thus causing excess demand that investors will realize can be met in nearby Phu Quoc, spurring development on the island eventually. On the positive side, the island is beautiful and close to resort destinations in SE Asia that are beginning to reach capacity limits due to increasing numbers of Chinese and Russian tourists. Also, Phu Quoc would make a logical cruise ship stop for boats that enter the Gulf of Thailand.

Even if Phu Quoc Island fills with 2nd generation resorts, the question of who will vacation there depends on how places like Phuket and Bali evolve. It seems to us that Bali is being converted to high-end tourism and 2nd homes for the rich. Phuket is at a cross-road. The Thai Island's airport is near capacity. Resort owners on the island can try and price out the masses of Chinese and Russians by upgrading, or they can remain as is and let the less wealthy travelers crowd out the bigger spenders. Either way, Phu Quoc has a great chance of getting the excess travelers.

Con Dau, another island in the south of Vietnam, already looks to become an exclusive place for high-end tourists who want the private island experience. Angelina Jolie and Brad Pitt were guests once. We don't expect any upgrades in the airport over the next ten years, so it will remain a niche destination for the wealthy, and possibly a 2nd home market.

South of *Can Tho*, we expect one or two 3rd generation resorts to provide high-end hospitality options in the Mekong River Delta that combine luxury resorts with traditional style of the people who have live there for centuries.

²⁴ www.tuoi-trenews.vn/cmlink/tuoi-trenews/society/governmentto-adopt-mechanism-for-phu-quoc-island-1.87264

²⁵ *Mexican Tourism: Export Growth and Structural Change since 1970*, Michael Clancy. *Latin America Research Review*, Vol 36, number 1. 2001.



Vietnam's Coastal Development & Primary Tourism Customers

Key: Type of development / who will visit
 Green= Already Being Developed
 Yellow = Developed between 2013-2017
 Orange = Developed after 2017
 Red = No resort development

Other Considerations

China / Vietnam Relations

Invariably, when discussing the potential of Chinese tourism in Vietnam, the concern about how each country's citizens feel about each other is mentioned. Once again we point to the Mexico/USA comparison. Despite causing a drug war that has led to tens of thousands of murders in Mexico and threatening to build a wall to keep them out, Mexican resorts welcomed over 20 million Americans in 2012. Vietnamese people will not refuse China's money.

We also feel as China's economy moves more towards consumerism, manufacturing costs in China will rise and factories will move to Vietnam. In ten years, instead of cheap Chinese goods being imported to Vietnam, Vietnam will be exporting consumer goods to China. This will alleviate some of the tensions.

Local tourists

Obviously the number of local tourists will increase over the next ten years, many of whom will visit the resorts designed for international tourists. This happened in Mexico, too.

The North

Halong Bay, Hanoi, and cross-border traffic from China will all receive more visitors than most places on the coast. The number of cross-border arrivals will increase over time, but at a slower rate than the total number of visitors. By 2022, we expect cross-border Chinese arrivals to be about 25% of total Chinese arrivals.

Our projection for new the new supply of hotel rooms needed to meet demand includes hotels needed in the north part of Vietnam.

India Tourists

Our demand curve may be conservative if Vietnam is able to attract the new tourists from India. McKinsey predicts India's economy to swell with new middle class consumers who will also be traveling internationally for the first time. Our forecast for China is primarily based on Vietnam's competitive advantage of being a close, cheap, warm destination. For the most part, these are not competitive advantages for Vietnam when competing with Thailand, Sri Lanka, and Cambodia for Indian tourists. However, others have suggested that simply being in the geographic center of these new consumers is enough of an advantage.

Graph 3: Asia's Population Center of Gravity²⁶



Russians

While still not accounting for a great number of tourists, Russians are one of the fastest growing markets to be traveling in SE Asia, including Vietnam. The number of Russians visiting Bali and Phuket doubled in 2012²⁷. With direct flights from Eastern Russia (and now Moscow), Cam Ranh is a likely place for continued growth, especially if Syria's revolution and the unrest in the Middle East spill into Turkey. The growth in Russian travelers will be offset somewhat by a decrease in North Americans and Europeans.

What Types of Hotels will be Most in Demand

Our assumption is that while Chinese tourists currently do not spend much, China's economic growth will not only create new consumers, it will create wealthier consumers. The incredibly large number of new travelers will be more financially diversified. However, the lower end of the market (3 and 4 star) will be ideal for those Chinese who come to Vietnam because it is cheaper than other international destinations. We still feel enough of the wealthier classes will visit Vietnam for other reasons to make all resort options viable, as long as there is a good plan and it is implemented.

²⁶ <http://thedevelopmentadvisor.com/vietnam-coastal-tourism-resort-development-destination/>

²⁷ <http://phuketwan.com/tourism/calling-quality-tourists-phuket-needs-ever-17670/>

Conclusion

Like other real estate markets in Vietnam, the hospitality sector is currently experiencing excess supply because of monetary policies of the government as a response to the international financial crisis back in 2009-2010. Unlike the office and residential markets, the hospitality market has not had a reduction in demand, so it will bounce back much faster. After 2013, we expect the growth in supply to be lower than growth in international arrivals, resulting in higher revenue per room rates. As demand increases exponentially in the next 10 years due to the increase in China's middle class, resort development in Vietnam will have a hard time keeping pace and asset prices will increase. If we are correct, then 2013 is an opportunity to buy low.

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ⁱ 33 million international tourists would have ranked #7 in the world in 2012.

ⁱⁱ *U.S. Tourism in Mexico; An Empirical Analysis*, William B. Stronge & Milton Redman. 1982

ⁱⁱⁱ For example, S^0 is the supply of resort rooms near major airports, closer to China, in locations with year round warm temperature, and have cultural attractions nearby. The supply curve S^1 would be less desirable locations, and S^2 would be perceived as less desirable location than the other two. Theoretically, nearly an infinite number of these supply curves occur, not just three. Since the best locations will be developed the quickest, they will also be first to reach maximum supply.

^{iv} Using the number of 3,4 and 5 star hotels in Vietnam according to VNAT and average room numbers provided by Grant Thortan

^v This amount of international tourists would rank Vietnam #7 (behind Turkey) in 2011. By the year 2022, our forecast is that Vietnam will rank in the top 15 countries.

^{vi} In 2011, Mexico had 155,000 five-star rooms. The total number of international arrivals per 3-5 star room has dropped significantly since 1990.

^{vii} I believe Thailand's beach resort market grew in a similar fashion, but I have not researched it and only have a little first-hand knowledge.

^{viii} In almost all cases, when we use the word "good" or "bad", it means the investment provides a discounted cash flow value higher (good) than the cost of capital.

^{ix} Accor managed the Novotel Phan Thiet for several years until recently. A Pullman hotel is being built in Vung Tau, and the Thai Resort Company Anantara has a resort in Phan Thiet.

^x On March 1st, 2013, the MGM Grand ended their management agreement with this project due to delays. We expect ACD to eventually get the casino license and find another casino brand to manage. However, the delay, which we assume was caused by the Vietnam Government has many implications which we will address in another report later.

^{xi} During the 1980's, the Mexican economy went through a period of privatization at which time these resorts were sold to private investors.