

Melvin Gold Consulting Ltd.

Specialist consultants to the hotel industry

The Directors
Travelodge
Sleepy Hollow
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12 March 2009

Dear Sirs

Re: Consultancy related to hotel supply structure in Edinburgh

In 2007 we undertook research on behalf of your company related to the hotel supply structure in the UK and potential future growth potential, especially in the budget sector. That report remains in the public domain through your website and ours. Since that time you have continued your growth pattern as envisaged. Now you have asked us to consider, after research and as a case study, the growth and impact of budget supply in the Edinburgh hotel market. You now have 6 hotels in Edinburgh, with more in the pipeline, and the most recent openings have come from acquisition and conversion of formerly mid-market hotels.

We thank you for this new instruction and our findings are reported in this letter report. For the sake of brevity, this letter report remains subject to the same terms and conditions as our earlier report which is available on the internet. For the avoidance of doubt, no third party should rely on this report without retaining their own advisors.

Methodology

In undertaking this research and preparing this report we have:

- Reviewed and relied upon published sources of information, some of which are referred to within this report;
- Utilised a hotel database that we developed during the previous assignment in 2007. This originated from Hotel Data Ltd. but was significantly updated by ourselves for the previous assignment;
- Further updated the database using the internet, published sources and by telephone calls to selected properties.

This has been a short form exercise and has been conducted entirely from the desk without the benefit of a visit to the city. We believe that we have become aware of all significant hotels open in the city and many of the smaller properties, however we have not sought to conduct a full audit and we have not explored the current development status of all future developments in the city.

We have largely sought to focus on the Edinburgh market defined by the city's ring road and the area just beyond it including Musselburgh and Edinburgh Airport. The city's administrative boundary extends significantly to the west of the city beyond South Queensferry and we have not included this area in our own work. We can advise of the postcodes we have included if required.

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Summary of findings

In summary we can report that:

- Travelodge is now the largest budget hotel operator in Edinburgh with 6 hotels and 625 rooms currently in operation (once the Edinburgh West End Travelodge completes its refurbishment programme in early April);
- Travelodge is the second largest hotel operator in the city and the largest operator of a single brand. InterContinental Hotels has more rooms in total operation but these are in the Holiday Inn and HI Express brands;
- Branded budget hotels now comprise 23.5% of the city's hotel supply (excluding small units etc) compared to 19.5% at the time of the 2005/6 hotel audit;
- Although the city is actively seeking to attract further hotel development, this is likely to be curtailed to some extent by current economic circumstances. The extent of current budget hotel developments (mainly your own developments) is adequate to ensure that the budget sector will gain an additional share of supply through the current phase of the cycle;
- At 20.4% (of currently quantifiable supply), the level of budget hotel supply in the city is low in comparison to many other major UK cities and almost certainly below the potential proportion of supply that will be operated by branded budget hotel operators in the future (see our previous study). Furthermore, with growth through both new development and acquisition of outmoded mid-market supply, the proportion of branded budget supply seems certain to grow further.

Current level of branded budget supply

Based on our research we summarise in table 1 below the current level of branded budget supply in the Edinburgh hotel market. We have reviewed the UK budget hotel brands identified by TRI Hospitality Consulting in their publication *Budget Hotels 2008 UK* and verified the extent of hotel operation in Edinburgh from each of the identified brands. We believe this is a consistent approach with what has become the industry standard although some may dispute whether Jury's Inn is truly a budget hotel brand.

Table 1
Current branded budget supply in Edinburgh

| | Hotel | Rooms |
|---------------------|-----------|--------------|
| Travelodge | 6 | 625 |
| Premier Inn | 6 | 620 |
| Holiday Inn Express | 3 | 384 |
| Jury's Inn | 1 | 186 |
| Ibis | 1 | 99 |
| Innkeeper's Lodge | 1 | 28 |
| Total | 18 | 1,942 |

Source: Melvin Gold Consulting research

Historic growth of branded budget hotels in Edinburgh

While we do not have a complete picture of the opening dates of each budget hotel in Edinburgh, we are able to provide some information which demonstrates more rapid growth in recent years than has historically been the case.

In the case of Travelodge, your first hotel was in Musselburgh in 1989 followed shortly after by the Dreghorn property in 1990. The Central property opened in

1999. In the past year you have opened three further properties in the city, all following conversion of former mid-market properties, two former Swallow hotels and one former Menzies property. In each case you have been able to develop more bedrooms than previously existed on these sites.

In this report we have reviewed and utilised the Tourism Accommodation Audit (hereinafter “Audit”) prepared by the Tourism Resources Company for Scottish Enterprise in September 2006 (this is available at http://www.scotexchange.net/full_report_oct_2006.pdf). This report also refers to a prior study conducted in 1999. Thus it is useful in accessing historic information.

According to information in the Audit, Premier Inn, in its former guises, developed at least three of its hotels in the 1998 – 2004 period – 30 rooms in 1998, 152 rooms in 1999 and 112 rooms in 2003. The city’s first Holiday Inn Express was constructed in 2004 with 161 rooms and the Ibis was built in 1998 with 99 rooms.

The Audit reports that in 2005 there were 9 Lodges (which conform to branded budget hotel definition) in the city with 890 rooms. However this most likely understates the position since we believe the Ibis, Jury’s Inn and Innkeeper’s Lodge properties would not have been included in this definition and the South Queensferry Premier Inn (70 rooms) would need to be excluded as it is outside the geographic area we have reviewed. We have also adopted a conservative approach with regard to the Premier Inns, assuming that they all pre-existed the Audit. Overall we consider that in 2005 there were probably 14 properties to consider with a total of 1,461 rooms. Thus the number of properties has increased by 29% and the quantum of rooms by 33.6% in the past 3 years. The difference has been caused by the opening of three new Travelodges and one new Holiday Inn Express and there were also two extensions to Premier Inn properties. There are some unverified assumptions in these figures but overall we feel they are a conservative estimation.

Quantification of total supply and proportion of branded budget supply

Our database indicates that there are currently 86 hotels in Edinburgh (as defined above) with a total of 8,299 rooms. This includes only hotels with more than 20 rooms. In Scotland there is a separate definition for Small Hotels, being those with between 6 and 20 rooms. Our database includes 104 such hotels with a total of 1,204 rooms. Many of these will fall within the definition of bed and breakfast, guesthouses and restaurants with rooms and we have not undertaken adequate research to differentiate since it is beyond the brief of this current assignment. Thus from the perspective of this research, which is a different basis than used in our previous research, we have considered only hotels of more than 20 rooms, and, from the Audit, properties defined as Lodges.

On this basis we consider our current research compared to the Audit and the 1999 figures reported in the Audit and present these in table 2 below. We also show some relatively comparable figures from the Audit illustrating the growth of hotels in Edinburgh since 1990. The sample base considered in these two sets of figures is different, as defined in the table, but nevertheless we feel it appropriate to show both data sets since it does illustrate the overall supply growth in the city which has doubled in less than 20 years. In the same period budget supply has grown manifold and now represents 23.5% of hotel supply (excluding small hotels etc.) in the city.

Table 2
Quantification of hotel supply in Edinburgh 1990-2008 and
proportion of budget supply

| | Hotels | Rooms | Rooms CAG% | Avg Rooms added per year | Branded budget rooms | % branded budget to total |
|--------|---------------|--------------|-----------------------|---|-------------------------------------|--|
| 1990 * | n/a | 4,500 | n/a | n/a | 117 | 2.6% |
| 1998 * | n/a | 6,500 | 4.7% | 250 | 460 | 7.1% |
| 2005 * | n/a | 8,019 | 3.05% | 217 | 1,461 | 18.2% |
| 2005 + | 88 | 7,481 | n/a | n/a | 1,461 | 19.5% |
| 2007 | 82 | 7,803 | n/a | n/a | 1,503 | 19.3% |
| 2008 + | 86 | 8,299 | 3.52% | 272 | 1,942 | 23.5% |

* = comparable and includes Hotels, Small Hotels, Lodges, Inns and Restaurants with Rooms
+ = comparable and includes Hotels and Lodges
CAG% = Compound Annual Growth %

Source: Melvin Gold Consulting Research; Edinburgh Tourism Accommodation Audit 2006

In analysing the data, the characteristics of the Edinburgh hotel market and our methodology must be specifically borne in mind. There are a large number of small hotel, bed and breakfasts, guest houses, inns and restaurants with rooms in the city. Our research indicates that there has been some small growth in these segments in recent years but this is relatively inconsequential compared the growth in larger hotels. In 2005 these smaller categories were quantified at 2,987 rooms in the City of Edinburgh.

In the table below we return to city by city data from our 2007/8 report (which does incorporate minor revisions to Edinburgh data used at that time in the light of revised geographic area and some new knowledge).

Table 3
Analysis of Serviced Accommodation in the UK's 10 largest cities
by category (2007 data)

| | Full Service | Mid- Market | Budget | Independent |
|-------------------------|-------------------------|------------------------|---------------|--------------------|
| <i>Ratio (%)</i> | | | | |
| G.London | 32.6 | 13.8 | 11.6 | 42.0 |
| G.Manchester | 23.3 | 25.3 | 23.5 | 27.9 |
| Birmingham | 28.9 | 19.0 | 28.9 | 23.2 |
| Leeds | 24.9 | 21.9 | 26.7 | 26.5 |
| Glasgow | 30.2 | 19.4 | 31.4 | 19.0 |
| Sheffield | 10.2 | 30.0 | 33.0 | 26.8 |
| Bradford | 9.3 | 31.6 | 16.3 | 42.9 |
| Edinburgh* | 39.9 | 13.0 | 16.9 | 30.2 |
| Liverpool | 26.2 | 15.4 | 36.5 | 21.9 |
| Bristol | 24.1 | 29.3 | 24.0 | 22.6 |
| <i>Edinburgh (2009)</i> | <i>36.9</i> | <i>15.2</i> | <i>20.4</i> | <i>27.5</i> |

* 2007 data adjusted for comparable geographic area as used for this study

Source: Melvin Gold Consulting analysis; Various City and Regional Tourist Boards

The 2007 information from our earlier survey showed that, using all the data in our database, Edinburgh had the lowest proportion of budget supply, apart from London (and after revision, Bradford). Revisions and updating of our database, and particularly the growth in budget supply in the past couple of years, now mean that Edinburgh's budget supply on this basis can be quantified at 20.4% of the supply in our database (which includes 9,503 rooms in the city including some of the smaller serviced accommodation units). This data is directly comparable with our earlier methodology. We have not revised the data for other cities as part of this exercise but it can be seen that Edinburgh's proportion of branded budget hotels is still low relative to other major UK cities. The data emphasises that branded budget hotels have grown from 16.9% of the serviced accommodation market to around 20.4% in less than 2 years, the key driver for this being Travelodge's acquisition and conversion of three existing hotels.

Apart from the changes caused by Travelodge's growth, the most significant recent openings (including number of rooms and our classification in table 3) include the Hotel du Vin (47 rooms, full service), Quality Street City Serviced Apartments (37 rooms, mid-market), Holiday Inn Express Cowgate (78 rooms, budget) and Novotel Edinburgh Park (170 room, mid-market). There has also been a 50 room extension at The George (Principal Hotels, full service), and at some of the Premier Inns (budget). The Point Hotel with 139 rooms, previously considered as independent, has now been re-classified as mid-market since it has re-branded to Accor's Mercure brand.

The net impact of all the above is that budget hotel rooms in the city have increased by 439 rooms since our 2007 report, and now account for 20.4%. Branded mid-market hotels have also seen an increase by 284 rooms whereas full service and independent hotels have both seen a small decline despite the overall rooms growth.

Hotel branding in Edinburgh

Table 3 illustrates that we consider 27.5% of the city's total supply (including smaller units) to be independent hotels, the remainder being part of international, national or regional chains. As part of our research we have analysed the quantum of supply operated via brands of various companies and have sought to identify the 5 largest operating companies in the city. These are presented in table 4 below.

Table 4
Leading hotel operating companies in Edinburgh

| | Hotels | Rooms | |
|-------------------------|---------------|--------------|--|
| Intercontinental Hotels | 5 | 788 | Holiday Inn 404, Holiday Inn Express 384 |
| Travelodge | 6 | 625 | |
| Premier Inn | 6 | 620 | Ibis 99, Mercure 139, Novotel 350 |
| Accor | 4 | 588 | |
| Hilton | 3 | 588 | |

Source: Melvin Gold Consulting research

It can be seen from the above that InterContinental Hotels, the world's largest hotel company, has the most rooms in operation in Edinburgh followed by the UK's two largest branded budget hotel companies Travelodge and Premier Inn. Europe's largest hotel company, Accor, is in 4th place albeit with three brands in operation. Hilton has the same number of rooms.

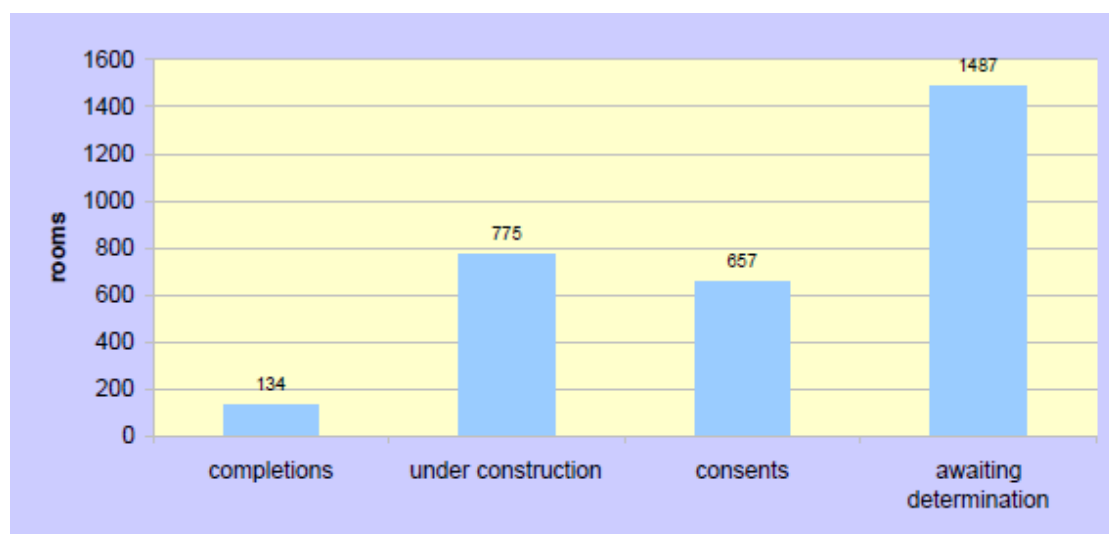
As a result of its recent growth in the city, Travelodge has now overtaken Premier Inn as the city's largest hotel brand.

Future supply growth

Following the 2006 Audit, the City of Edinburgh determined that it had an ongoing shortage in hotel supply. This was quantified as a need for around 4,000 additional hotel rooms by 2015, especially in the three and four star categories. The study had limited specific recognition of the branded budget hotel sector which we do find unusual, especially given that it has been the main driver of hotel supply growth in the UK for many years, and we expect that to remain the case in the future (see our previous study).

The various public sector bodies active in promotion of tourism and tourism development in the region have been active in progressing this objective. In particular there is a summary document with 35 potential hotel sites that has been produced, and Edinburgh city council planning department is unique in our experience in that they publish an annual status report of hotel planning applications. This activity has borne some fruits already as discussed above.

A number of openings are expected this year. These include Apex Waterloo Place (187 rooms), Hotel Missoni (a new Rezidor brand, 136 rooms) and Fraser Suites (75 rooms). In the longer term there are plans for a Park Inn at Edinburgh Airport (due to open in early 2010 with 160 rooms) and a Citadines Hotel (107 rooms). We have also noted reference to a Premier Inn project on Princes Street although we do not have specific details at this stage. There are a large number of hotels with permission or seeking permission, as well as the sites in the aforementioned brochure. It is beyond the scope of this assignment to fully investigate the future supply situation in the city. In the longer term we would expect supply to increase but in the current economic circumstances (the credit crunch, the UK in recession and hotel trading downturning markedly) it is normal for the development cycle to slow down and for project materialisation to be delayed. As at the date of the last hotel development report published by the city council in Edinburgh, *City of Edinburgh Hotel Schedule 2007 – 2008*, published in May 2008 the following chart represents the situation with regard to future hotel development:



Of the 775 rooms under construction, 328 were open before the date of this letter report and are therefore included. Therefore, using the city's report as a basis,

there is the potential for a further 2,591 rooms to be developed over the next few years. Thus by, say, 2012 (economic circumstances permitting) there is the potential for the hotel supply to increase to around 10,890 rooms.

In terms of your own activity we understand that you expect to have a further 285 rooms trading in the city by the end of 2009 (one acquisition/conversion, a new development at Edinburgh Airport and a new development at Cameron Toll). This would bring your total rooms to 910 rooms and make you the largest hotelier in the city. Furthermore the opening of 212 new build rooms in the context of a total of 610 new rooms this year is 34.8% of new supply, and with one conversion as well, will see branded budget supply become a more significant proportion of the city's supply by the end of the year. Notwithstanding that, we have earlier noted that Edinburgh has a relatively low proportion of branded budget supply compared to total serviced accommodation supply and this would appear to leave scope for further development both from yourselves and competitor brands. We understand that you have several other projects which are confidential at this stage and these will serve to increase the proportion of branded budget hotels still further in the city in the months and years to come.

We thank you for having retained us on this most interesting assignment and remain at your service for further advice or discussion concerning this report or our findings generally.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Melvin Gold', written in a cursive style.

Melvin Gold