Foreign Investment in China's Tourism Sector – Insights and Learnings

Presented at: ICEX Palma de Mallorca
Prepared by: InterChina Consulting

April 20th, 2006
Presentation Contents

- China’s Tourism Industry

- Foreign Investments in Theme Parks
  - Overview
  - Case Studies

- Foreign Investments in Travel Agencies
  - Overview
  - Case Studies

- Conclusions and Recommendations
Market Overview

- Total revenue of USD 96 million in 2005
- Employment of 7 million people directly and 33 million people indirectly
- World’s largest tourist destination and 4th largest in outbound travelers by 2020
- Rapid growth in business travel market.
  - Over USD 30 million in 2004 for both domestic and outbound business travel.
  - World’s third largest market for business travel within next five years.
China’s Tourism Industry - Overview
Driven by domestic and inbound travel sectors

- Domestic and inbound travel promoted by:
  - Unparalleled historical tourist attractions in the world.
  - Improving infrastructure and service quality.
  - Growth in disposable incomes in urban areas.

**Overnight Visitors* Among International Tourists**

**China’s Domestic Tourism Market (Unit: 1,000)**

*Note: Overnight visitors refer to international tourists who spend over one night in China

*Source: China Statistical Yearbook 2005*
China’s Tourism Industry – Overview
And also driven by outbound travel sector

- Significant rise in outbound travel due to
  - Economic expansion.
  - Average income growth in urban areas.
- 81 tourist destinations approved till February 2006, 76 of which can be reached through travel agencies.
- World’s largest outbound tourist market.
- 31 million outbound trips in 2005.

Top 10 Destination Countries and Regions – Outbound Travel, 2005

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country / Region</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Hong Kong</td>
</tr>
<tr>
<td>2</td>
<td>Macau</td>
</tr>
<tr>
<td>3</td>
<td>Japan</td>
</tr>
<tr>
<td>4</td>
<td>Vietnam</td>
</tr>
<tr>
<td>5</td>
<td>South Korea</td>
</tr>
<tr>
<td>6</td>
<td>Russia</td>
</tr>
<tr>
<td>7</td>
<td>Thailand</td>
</tr>
<tr>
<td>8</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>9</td>
<td>Singapore</td>
</tr>
<tr>
<td>10</td>
<td>Malaysia</td>
</tr>
</tbody>
</table>

Source: Exit-entry Administration of The Ministry of Public Securities, P.R.C.

Number of Chinese Outbound Tourists

Source: China Statistical Yearbook 2005, China Tourism Administration
Presentation Contents

- China’s Tourism Industry

- Foreign Investments in Theme Parks
  - Overview
  - Case Studies

- Foreign Investments in Travel Agencies
  - Overview
  - Case Studies

- Conclusions and Recommendations
China’s Theme Parks
Large number, but relatively under-developed

- 2,500-3,000 theme parks in China with total investment of RMB 150 million.
- Estimated market size of RMB 9 billion
  - Average entry fee of RMB 30
- Existing theme parks relatively undeveloped
  - Only 100 theme parks with investment over RMB 100 million
  - Less than a dozen with visitors over 1 million or revenue over RMB 100 million annually.
  - 75% of the parks are in red due to
    - Sub-standard facilities with little attraction to visitors
    - Lack of expertise in operational management
  - Likelihood of industry consolidation
- Opportunities for future development
  - Emerging middle-class segment, with annual income over USD 5,000
  - 120 days off a year, including three weeklong holidays per year
  - Heavy investment in transportation links
China’s Theme Parks
Location of major theme parks
China’s Theme Parks
Foreign investment evident, but now stricter approval

- Regulations on foreign investment in theme parks
  - Investment in large theme parks is restricted, which requires the approval from the State Council

- Foreign investments in theme parks
  - Entered the Chinese market more than ten years ago
  - Major investment on hold due to poor transportation, low purchasing power and government restrictions

- Recent Foreign Investments
  - The World Carnival
  - Hong Kong Disneyland
  - Landmark Entertainment Group

- Potential foreign investments:
  - Disney in discussion with Shanghai government: Shanghai Disneyland
China’s Theme Parks – Case Study
World Carnival
China’s Theme Parks – Case Study
World Carnival

- **Background**
  - Established in 2001 to open the China market
  - Most successful mobile carnival in the world

- **Performance in Mainland China**
  - Three events since 2003
    - World Carnival Shanghai 2003
    - World Carnival Beijing 2004
    - World Carnival Beijing 2005
  - Revenue of RMB 400 million, entertaining more than 4.7 million visitors
China’s Theme Parks – Case Study
World Carnival

- Operation Model
  - Short-term lease from the local government
  - Take lease on most entertainment facilities
  - Most staff employed on temporary basis
  - Alliance with world food and beverage giants (e.g. Coca-cola and KFC) for sponsorship

- Key Success Factors
  - Lease system enables the newest and most exciting attractions
  - Events only held in large developed cities as tourism destinations
  - Event mobility enhances the curiosity and eagerness of the visitors
  - The entry-plus-per-attraction fee system offers more flexibility
  - Brand image attracts government support and commercial sponsorship
China’s Theme Parks – Case Study
World Carnival

- **Company Establishment in Beijing**
  - Set up an investment company in Beijing in 2004
  - Difficulty incurred for the establishment of a branch company, for the purpose of the carnival event: protectionism from the local government
  - Support from Beijing government, motivated by tax contribution and international recognition

- **China Expansion Plan**
  - World Carnival event in Beijing once every year till 2008
  - Expand to large second tier cities, including Hangzhou, Chengdu and Wuhan

- **IPR Challenges**
  - Unqualified “copycat” Carnival events discredit World Carnival’s image in China
  - Trans-Ocean Carnival in Chengdu caused various complaints from the visitors and service providers.
  - As a result, World Carnival had to reschedule its own event in Chengdu, and announced that the two events are not related to each other.
China’s Theme Parks – Case Study
Universal Parks & Resorts

- **Background**
  - Theme park subsidiary of Vivendi Universal Entertainment (VUE)
  - Five amusement parks in the U.S., Japan and Spain, all based on movie theme

- **China Operation**
  - Announced in 2002 to set up a USD 870 million investment in Shanghai
  - Two JV Partners, influential SOEs in RE and tourism industries
  - Planned to start construction in 2003
  - Suspended in 2004 after the visit of a central government official
  - Various reasons in discussion
    - Macro-control from the central government on fixed investment
    - Shanghai government in favor of potential investments from Disney
China’s Theme Parks – Case Study
Intra-Asia Entertainment Corporation
China’s Theme Parks – Case Study
Intra-Asia Entertainment Corporation

■ Intra-Asia Background
  – Founded in 1997 with HQ in Los Angeles
  – Active in tourism, digital TV and digital entertainment industries in Mainland China

■ Fuhua Amusement Park
  – Located in Weifang, Shandong Province
  – Opened in April 1994, the largest amusement park in Shandong
  – Total investment of RMB 300 million
    □ Including over RMB 100 million for the new “Water Palace”
  – Shareholding Structure: Intra-Asia: 85%; Weifang Neo-Luck: 15%
  – More than 30 rides and facilities
  – Target consumers: Residents of Weifang and surrounding cities
China’s Theme Parks – Case Study
Intra-Asia Entertainment Corporation

- **Performance**
  - Profitable since opening
  - 1.37 million visitors in 2003

- **Future Planning**
  - Pushing up the attendance by adding more rides and enhancing the service levels

- **Analysis**
  - **Strengths**
    - No competition in the surrounding areas
    - Various ticket packages offer more flexibility
    - Leveraged Chinese partner for government support
  - **Weaknesses**
    - Business volume challenged by the location in a small city with low income level
Introduction

Presentation Contents

- China’s Tourism Industry

- Foreign Investments in Theme Parks
  - Overview
  - Case Studies

- Foreign Investments in Travel Agencies
  - Overview
  - Case Studies

- Conclusions and Recommendations
Foreign Travel Agencies – Overview
High threshold requirements and restriction on services

- Minimum thresholds for foreign travel agencies:
  - JV registered capital: > RMB 4 million (€ 400,000).
  - Tourism related revenue: > US$ 40 million (€ 33 million).
  - Members of tourism associations of home countries.

- Still prohibited from “outbound” travel service

<table>
<thead>
<tr>
<th>Legal Qualification</th>
<th>Travel Service</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Domestic</td>
</tr>
<tr>
<td>Domestic</td>
<td>Chinese</td>
</tr>
<tr>
<td>International I</td>
<td>Chinese &amp; Foreign</td>
</tr>
<tr>
<td>International II</td>
<td>Chinese Only</td>
</tr>
</tbody>
</table>
Foreign Travel Agencies – Overview
Outbound travel services are the main revenue generator

<table>
<thead>
<tr>
<th>All Travel Agencies</th>
<th>International Travel Agencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number</td>
<td>Number</td>
</tr>
<tr>
<td>&gt;15,000</td>
<td>1,500</td>
</tr>
<tr>
<td>Revenues</td>
<td>Revenues</td>
</tr>
<tr>
<td>90%</td>
<td>64%</td>
</tr>
<tr>
<td>37%</td>
<td>36%</td>
</tr>
<tr>
<td>10%</td>
<td>22%</td>
</tr>
</tbody>
</table>

“Domestic” Qualification
“International” Qualification

Growing at 15% Per Annum

Includes Foreign Travel Agencies

International I Without Outbound
International II With Outbound
## Foreign Travel Agencies – Overview

Only 19 foreign travel agencies have been established.

### WFOE
- Jalpak International (China) Co. Ltd.
- ANA Tours China Ltd.
- NTA China International (China)
- Gulliver's Travel Associates (China) Ltd.
- Star Cruises Travel Agency (Shanghai) Company Ltd.

### Foreign-controlled
- TUI China Travel Co. Ltd.
- Shenzhen Skal Travel Service Limited (STSL SZ)
- BTI Jinjiang Travel (China) Co. Ltd.

### JV
- Beijing BTG-Accor Travel Co. Ltd.
- Beijing Morning Star-New Ark International Travel Service
- Carlson Wagonlit Travel China
- CITS-American Express Travel Co. Ltd.
- Diethelm Travel (Yunnan) Co. Ltd.
- Flight-Center Comfort Travel Co. Ltd.
- Hong Thai Travel (Guangdong)
- New Century International Tours Co. Ltd.
- Tianjin Tianxin International Travel Co. Ltd.
- Wing On International Travel Service Ltd. (Guangdong)
- Wuxi Weilin Holiday International Travel Service
Foreign travel agencies struggling to be profitable:
- Restricted from outbound travel services, which are the most profitable.
- Not cost competitive against local competitors in domestic travel services.

Focusing on areas where have competitive advantage:
- Inbound travel services.
- Domestic corporate travel services:
  - US$ 25 billion business (€21 billion).
  - Only 10% serviced by travel agencies
    - Among which only 20% serviced by foreign corporate travel companies, such as Carlson Wagonlit Travel (CWT) and American Express (AE)
    - The rest 80% belongs to local travel agencies, characterized by small and unprofessional businesses

Further liberalization of outbound:
- Nothing planned.
- If liberalized, local travel agencies unlikely to be competitive.
- Due to weak global network, overpriced and poorly operated.
Foreign Travel Agencies – Case Study
CITS-American Express Travel Co., Ltd.

- Background of American Express (AMEX)
  - The world’s largest travel management company
  - 1,700 travel services locations worldwide in over 130 countries

- First corporate JV travel agency in China
  - Established in Beijing in January 2002
  - Joint venture between AMEX and CITS, China’s largest travel agency
  - Fully licensed by CAAC (Civil Aviation Administration of China) and IATA (International Air Transport Association)

- Full services to business travelers, serving both local and foreign companies:
  - Air ticketing, hotel reservations, visas, convention arrangements
  - Both domestic and outbound
Foreign Travel Agencies – Case Study
CITS-American Express Travel Co., Ltd.

- **Achievements**
  - Sales revenue increased by 200% in the first 7 months
  - Expanded offices to Shanghai, Beijing and Sichuan in 2 years
  - Over 30 MNC clients in China: Ford, AT&T, SAP, McDonalds etc.

- **Leveraging Strong Synergies**
  - AMEX: Global travel management expertise
  - CITS: Local knowledge, operational know-how, and strong government influence on licensing
Foreign Travel Agencies – Case Study
Carlson Wagonlit Travel (CWT) China

- Background of Carlson Wagonlit Travel (CWT)
  - World leader in business travel management
  - Offices in more than 140 countries
  - Annual sales of US$ 11 billion

- JV established in January 2003 as CWT China
  - Joint Venture with China Air Service (CAS), China’s largest international air transportation company
  - CAS is also the first and one of the largest International Air Transport Association (IATA) member travel agencies in China
  - Beijing-based operation
  - Fully licensed for domestic and outbound air-ticketing
Business Focus
- Corporate Travel Services: air ticketing, hotel reservations, visas
- Currently all clients are multinationals and regional businesses, no Chinese corporate clients

Achievements
- Dramatic increase in sales revenues from US$20 million in 2003 to US$ 72 million in 2004
- Opened offices in Shanghai and Guangzhou

Key Success Factor
- Leveraged the Chinese partner, CAS, to get licenses for air ticketing
- Both CWT and CAS are very focused on corporate travel market segment, while the major competitors (such as CITS Amex), have partners who are leisure tour agents looking to diversify into corporate travel

Expansion Plan
- Expend business to domestic corporate clients
Presentation Contents

- China’s Tourism Industry

- Foreign Investments in Theme Parks
  - Overview
  - Case Studies

- Foreign Investments in Travel Agencies
  - Overview
  - Case Studies

- Conclusions and Recommendations
Conclusions and Recommendations

- Theme Parks
  - Large growth potential due to China’s emerging middle class
  - Focus: first tier cities with higher living standards.
  - Potential for strong support from the local government
  - May be subject to central government approval.
  - There is a risk of copycats.

- Travel Agencies
  - Sector has been greatly liberalized.
  - But outbound business, the most profitable, is still restricted.
  - Focus (for now): corporate travel services.
  - JV could lead to additional government approvals.
  - Need to be aware of HR challenge in this sector.

➔ Carefully developed market entry strategy will be critical.
Your Key to China

Beijing
Contact: Mr. Jan Borgonjon, President
Tel: +86-10-8451-2088
Fax: +86-10-6467-1943
Email: jan.borgonjon@interchinaconsulting.com

Shanghai
Contact: Ms. Friederike von Zenker, Senior Consultant
Tel: +86-21-6341-0699
Fax: +86-21-6341-0799
Email: fvzenker@interchinaconsulting.com

Spain
Contact: Mr. Eduardo Morcillo, Senior Consultant
Tel: +34-91-411-9302, 411-9283
Fax: +34-91-563-4783
Email: eduardo.morcillo@interchinaconsulting.com

Italy
Contact: Ms. Laura Tsui, Vice-President
Tel: +39-031-240-022
Fax: +39-031-272-566
Email: laura.tsui@interchinaconsulting.com

www.interchinaconsulting.com
Happy Kingdom – Shenzhen
Splendid China – Shenzhen
Xiangjiang Safari Park – Guangzhou
China Dinosaur Park – Changzhou
Suzhou Amusement Land
– Suzhou
Da Tang Dynasty Theme Park – Xi’an