

Surmang Foundation

***Economic and Cultural Revitalization
Through Tourism***

December 29, 2002

Eugene Lin

Overview

Project Objective

- ◆ Improve economic status of Chinese-Tibetan community by generating cash flow via high-end hotel and other travel-related services
- ◆ Give “face” to local community and educate visitors through exploration of local culture and customs

Meeting Objective

- ◆ Provide preliminary assessment of the feasibility of a Surmang Foundation hotel through consideration of market factors and investment rationale and risks
- ◆ Examine the demographics and profiles of two primary parties that are important to the operational success of the project: Consumers and Travel Intermediaries

Conclusion

- ◆ Market trends and competitive landscape point in Surmang’s favor, though achieving positive cash flow and successful marketing might be difficult to overcome, especially during the startup years
- ◆ Bringing aboard an expert in the field of Tibetan cultural tourism will help tremendously through valuable experience, connections, and credentials

Investment Thesis

- ◆ Unique assets in market with high barriers to entry
 - Surmang hotel would be situated in an irreplaceable location and insulated from potential competition
 - Niche over more popular destinations in Tibet, such as Lhasa, as Qinghai remains relatively untouched by visitors
- ◆ Unique experience
 - Ability to integrate local culture into the leisure experience would further distinguish Surmang from its peers
- ◆ Attractive leisure customer base
 - Surmang would cater to affluent and established leisure travelers who are generally price inelastic and willing to pay premium rates for the “total experience” during various economic cycles
 - Well-positioned to benefit from an aging population and the growing propensity for leisure travel and accommodations
- ◆ Charitable and humanitarian
 - Benefit to local Chinese-Tibetan community through economic and cultural revitalization

Investment Risks

- ◆ While Qinghai Province may experience a high influx of visitors in the future, it is not a popular destination at present
- ◆ Earnings concentrated in one asset, with seasonal implications
 - With a niche customer base and restrictive traveling during winter months, Surmang would rely on continued interest in the Tibetan region of China as well as pleasant weather conditions during peak travel months
- ◆ In general, Revenue Per Available Room (RevPAR) and operating margins are subject to economic fluctuations
 - Pervasive economic weakness throughout the U.S. and Europe may hurt bottom-line results (e.g., worldwide effects of September 11 event)
- ◆ Political and economic instability, as well as currency fluctuations, could impact near-term financial viability
 - While potential long-term returns on investments are attractive, there is added risk due to near-term uncertainty and less predictable demand
 - Chinese-Tibetan relations have been volatile; upcoming changes in CPC administration may alter traditional policies

Travel & Tourism in Western China

By 2008, China is expected to be one of the top four destinations for international visitors. By 2020, it may be the largest in the world.

Improving Policies . . .

- ◆ The most important growth factor is that the government has put a strong focus on the travel and tourism industry over the past few years
 - The industry is also beginning to diversify from its traditional focus on city-based holidays to outdoor activity and environmentally-friendly holidays, much of which takes place in the western regions of China
- ◆ With China's accession into the WTO, the Tibet Autonomous Region ("TAR") ^(a) is opening up to foreign investment, becoming a hotbed for growth in tourism
- ◆ Transportation has been improved through massive infrastructure investment
 - Over the next four years, the government is to invest heavily into building two new airports in TAR (Linzhi Airport and Shiquanhe Airport); renovation of existing airport in Xining; construction of Qinghai-Tibet railway
- ◆ Chinese government has recently issued more stipulations for travel agencies, further protecting tourists' rights

. . . Fueling Tourism Growth

- ◆ During the first 10 months of 2002, 8.4 million visitors traveled to Tibet, an increase of 24.5% over the same period last year (the number of domestic travelers increased 28.8%, while international increased 4.6%)
- ◆ Over the past 20 years, TAR has seen a fundamental shift in the geographic origin of tourists, from a primarily foreign one to a domestic one
 - Significant increases in per household income have popularized travel among the Chinese; and because of strict passport regulations and the cost of international travel, the majority of the increase impacts the domestic market

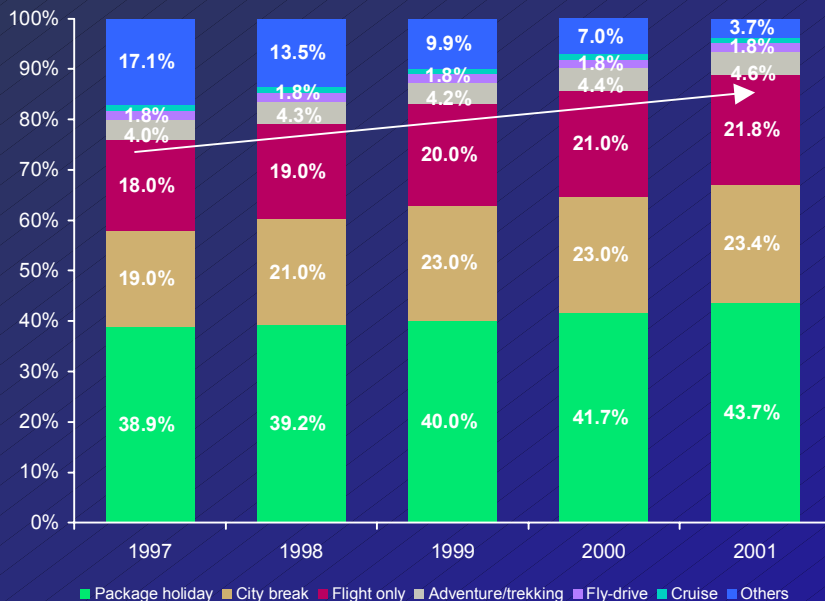
Source: Euromonitor and RDS Business & Industry.

(a) This presentation uses trends in Tibet as a proxy for future implications of Qinghai, as publicly available tourism information for Qinghai is scarce.

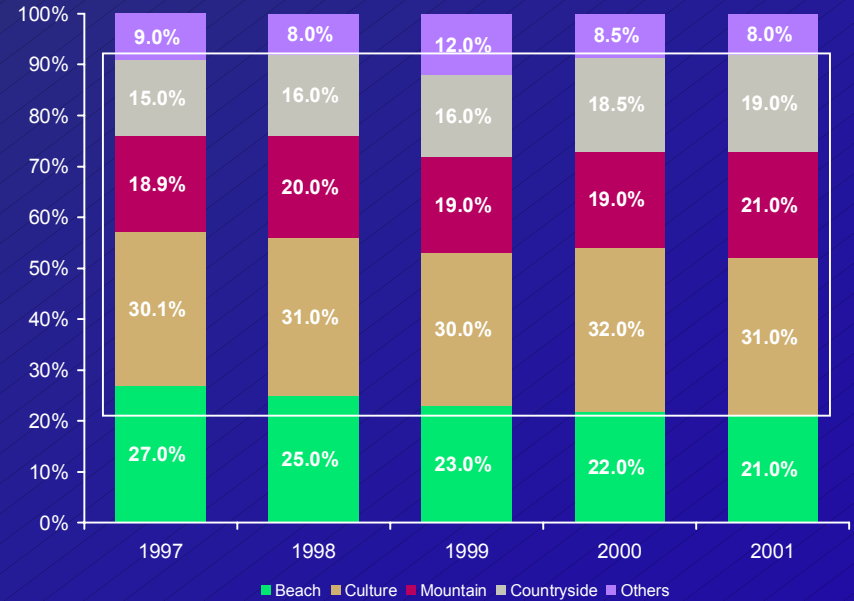
Trends in Cultural/Adventure Travel

- ◆ Although the market for adventure holidays is still in infancy, more and more vacationers, especially incoming tourists, seized the opportunity to make good use of the ever-improving road and rail infrastructure
 - The adventure sector achieved sales of RMB 135.7 million in 2001, a rise of 15.0% since 1997
 - Cultural and rural travel have also been on the rise, representing the majority of destinations

**Tour Operator Sales by Holiday Type
(Market Share %, 1997-2001)**



**Tour Operator Sales by Destination
(Market Share %, 1997-2001)**



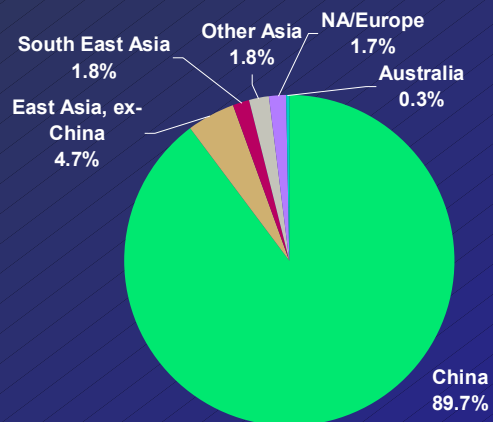
Source: National Tourism Administration, trade interviews, and Euromonitor.
 Note: "Others" refers to optional transport connections, shopping, and catering pre-arrangements

The Consumers

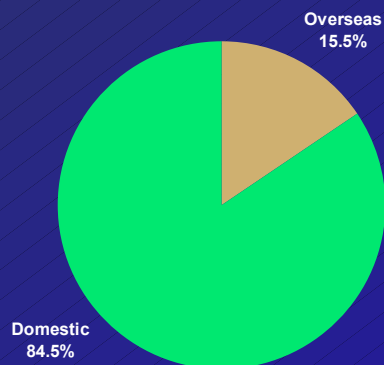
- ◆ Travelers to China predominantly live in China (90% market share); the same trend holds for visitors of Tibet – approximately 85% are from China
- ◆ With double-digit growth forecasted over the mid-term future, foreign interest will remain strong, led in absolute numbers by the non-China East Asian countries

Domestic vs. International Visitors

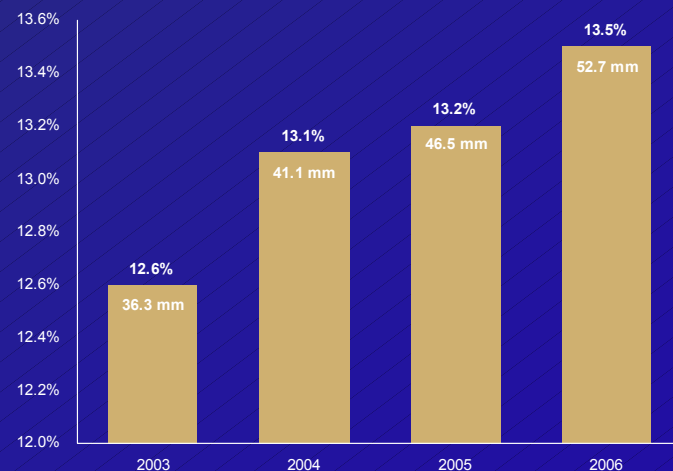
Arrivals to China
(Jan. 2001 to Mar. 2002)



Arrivals to Tibet
(Jan. 2002 to Nov. 2002)



Estimated Growth in Visitors to China



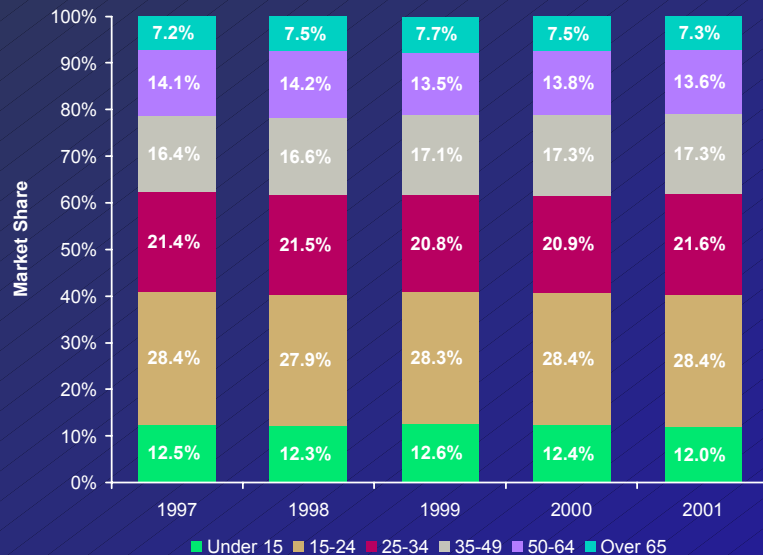
Source: Euromonitor and RDS Business & Industry.
Note: China figures include travelers from Taiwan.

Source: Euromonitor.

The Consumers *(continued)*

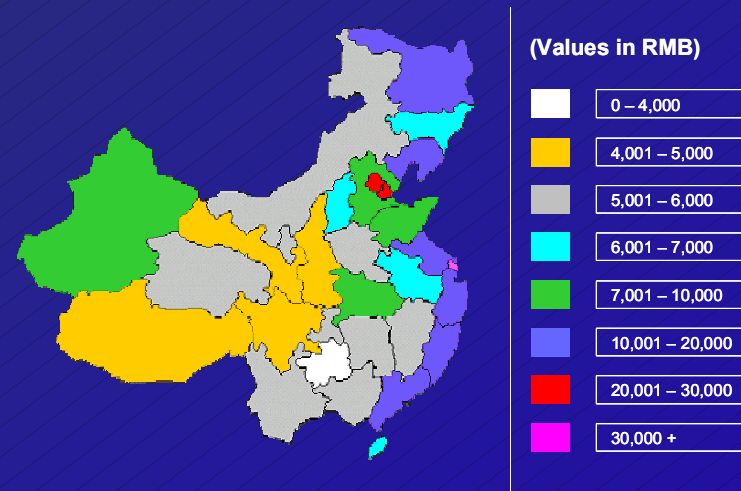
- ◆ Focus on consumers who have the time, money, and interest in cultural tourism
 - Both the affluent, adventurous youth and the established leisure travelers
- ◆ Most of the tourists from China are from coastal or economically developed areas such as Beijing, Shanghai, or the Guangdong Province in the south

**Holiday Taking in China
By Age Group (1997-2001)**



Source: National Tourism Administration and Euromonitor.

**Value of GDP
Per Capita By Province (2000)**



Source: Access Asia.

The Intermediaries

If Friends of Surmang can bring on board an expert in the travel field, it might consider directly coordinating with travel agents to generate the added revenue from cultural activity services.

Travel Agent

- ▲ Significant increase in revenue generation due to fees from internally-provided tour services; though must pay agents high commission
- ▲ Potential for more rapid feedback from consumers due to proximity and nature of relationship
- ▼ May be more difficult to pitch if Surmang were to decide to handle logistics without the support of tour operators with an established name; especially true with international agencies
- ▼ Most agencies will not actively promote vacation packages

Tour Operator

- ▲ Expertise in handling complex, multi-national logistics
- ▲ Marketing experience and scope even more crucial for remote, less popular destinations
- ▲ Established relationship with numerous travel agencies; ability to reach broader customer base
- ▼ May not have expertise in Qinghai Province, as most Tibetan cultural travel takes place in Lhasa
- ▼ Majority prefer to detail activities themselves, rather than follow a pre-determined suggested package

Travel Agencies and Tour Operators in China

Friends of Surmang should focus its efforts on the wealthy domestic market, though foreign travelers will be an important source as well.

- ◆ The travel agency market is highly fragmented with two major agencies capturing 9% of the market

Travel Agency Market Share 2000-2001

Company	2000	2001
China International Travel Services	5.8%	6.2%
China CYTS Tours	2.6	2.8
Others	91.6	91.0
Total	100.0	100.0

- ◆ On the other hand, two key players dominate the tour operator market, capturing 52.3% of the market

Tour Operator Market Share 2000-2001

Company	2000	2001
China International Forest Travel	31.3%	32.4%
China Base	19.6	19.9
Others	49.1	47.7
Total	100.0	100.0

Hotel Profit Drivers

The key to profitability involves both quality and volume – China is no exception. Fees from cultural activities and local transportation may compensate for lower volume.

*Hotel Profitability in China by Hotel Size
1998 (RMB in millions)*

Number of rooms	Revenues	Profit	Margin
500+	19,353	3,188	16%
300-499	14,892	(159)	(1%)
200-299	14,391	(548)	(4%)
100-199	17,437	(1,238)	(7%)
Under 99	15,163	(429)	(3%)
Total	81,236	814	1%

*Hotel Profitability in China by Star Rating
1998 (RMB in millions)*

Number of stars	Revenues	Profit	Margin
5	11,954	1,803	15%
4	13,411	364	3%
3	20,717	(334)	(2%)
2	9,316	(342)	(4%)
1	833	(32)	(4%)
No star rating	25,005	(645)	(3%)
Total	81,236	814	1%

Next Steps

- ◆ Model cash flow and profit projections
- ◆ Gain further insight into the tourism market and demographic trends of visitors of Tibet
- ◆ Begin writing business plan and gauging investor receptivity
 - Foundations, wealthy/charitable individuals, banks, and equity investors
- ◆ Evaluate optimal entity structure for Surmang hotel and whether such a structure is viable
 - Given Friends of Surmang's status as an organization under IRC §501(c)(3), starting a for-profit business in China may raise issues with IRS *if structured as a joint venture* with a Chinese organization
 - The China-U.S. WTO Agreement states that by the end of 2004, under certain circumstances, operators will be permitted to build 100% foreign-owned hotels
- ◆ Explore marketing venues: agents, online, trade journals, newspapers, brochures
- ◆ Assess employment needs

Appendix

U.S. Tour Operators

- ◆ The following tour operators have significant presence in Tibet or China.
- ◆ Several of these are part of United States Tour Operators Association (“USTOA”), an organization that only recognizes the best operators in the U.S. (USTOA operators move more than 10 million passengers annually and account for an annual sales volume of more than \$8 billion)

- **Abercrombie & Kent** ^(a)
- Absolute Asia
- Alpine Ascents International
- Asia Transpacific Journeys
- Backroads
- Boojum Expeditions
- **China Travel Service (U.S.A.) Inc.** ^(a)
- Cox & Kings
- Earth River Expeditions
- Footprints Travel
- Imaginative Traveler
- Intrepid
- **Journeys International** ^(a)
- Mountain Travel - Sobek
- National Geographic Expeditions
- **Tauck World Discovery** ^(a)
- **Uniworld** ^(a)
- Worldwide Adventures

(a) United States Tour Operators Association operators.