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Interview with Anatoly Kondratenko, Head of Development in Russia and CIS, Starwood Hotels & resorts Worldwide

Please outline Starwood's current presence in Russia and CIS and any major news and/or upcoming developments in the market there.

Starwood Hotels & Resorts Worldwide, Inc. (NYSE HOT) currently operates three hotels in Russia and a total of seven hotels in former USSR countries, including:

- Sheraton Baku Airport (Azerbaijan)
- Four Points by Sheraton Zaporozhye (Ukraine)
- W St. Petersburg (Russia)
- The National, a Luxury Collection Hotel, Moscow (Russia)
- Sheraton Palace Hotel, Moscow (Russia)
- Sheraton Metechi Palace, Tbilisi (Georgia)
- Sheraton Batumi (Georgia)

In 2011, Starwood opened three new hotels in Russia and CIS, marking a number of key milestones, including the highly successful debut of the W brand in Russia with the opening of W St. Petersburg and the entrance of Starwood into Ukraine and Azerbaijan.

As the largest country in the world and one of the fastest-growing outbound travel markets, Russia represents a great opportunity for Starwood. In the next four years, **Starwood will nearly quadruple its portfolio in Russia and the CIS** with 12 new hotels in Moscow, St. Petersburg, Rostov-on-Don, Perm, Kaluga, and Krasnodar in Russia, as well as in Kiev, Ukraine, Dushnbe, Tajikistan, Aktobe, Kazakhstan and Ismayilli, Azerbaijan.

With more than 70% of the world's economic growth coming from fast-growing markets over the next few years, Starwood is focused on expansion in developing markets such as Russia as well as key emerging markets including Ukraine and Tajikistan.

We have plans to expand our brands throughout the region with development partners who have a proven track record of success and are looking for a new and exciting growth vehicle.

As part of this strategy, Starwood is investing in development, sales and expanding its Starwood Preferred Guest (SPG) program in Russia, and will open 12 new hotels across Russia and CIS in the next four years. Key highlights include:

- The debut of Starwood in Kazakhstan with the opening of Sheraton Aktobe in 2013.
- The entry of Starwood into Tajikistan in 2013 with the opening of a new Sheraton hotel in the country's capital city of Dushanbe.
- Starwood's second Sheraton hotel in Moscow with the opening of Sheraton Moscow Sheremetyevo Airport in 2013.
- Further expansion into regional Azerbaijan with opening of Sheraton Ismayilli.
- The debut of Starwood in three emerging Russian markets with the openings of a Four Points by Sheraton hotel in Kaluga and a Sheraton hotel in Rostov-on-Don in 2014, followed by the opening of Sheraton Perm in 2015.
- The debut of Starwood in Kiev with the opening of Sheraton Kiev Olympiysky, Ukraine in 2014.
- Russia's first Aloft hotel with the new Aloft St. Petersburg. Scheduled to open in 2015.
- Sheraton Sochi scheduled to open in 2016.
- Four Points by Sheraton Krasnodar opening 2016 as well as Four Points by Sheraton Vnukovo Airport in Moscow.

How dynamic is the Russian market for the hotel sector (in terms of current and perspective performance, as well as development opportunities)?

The Russian market has a great potential. There are many big cities (more than 50) with not a single internationally managed or branded hotel. At the same time the hotels that opened in recent years demonstrate a solid performance and returns that are higher than traditional ones for developed

European markets. As crisis washed out a number of big multi-functional developments and made office and residential projects not as attractive as before many developers started to pay attention to the stable and more secured hotel sector where the entry ticket is maybe more expensive, but performance is more predictable.

Which locations in Russia does your group particularly see opportunities and why these?

Moscow is the biggest market for Starwood in Russia with two existing hotels and a hotel in development that will open at Moscow Sheremetyevo Airport in 2013. As it is the main financial, political and economic centre of the country, Moscow is a good fit for all of our brands.

We are also working to further develop our brands in St. Petersburg. While all of our brands have potential here, our focus is on growing our Sheraton brand in this market. However, we're not just talking anymore about St. Petersburg and Moscow, we're talking about markets throughout the country and throughout the CIS. Normally these are regional capitals or industrial centres that attract business travellers. Here we see a great fit for our select serve brands, Four Points by Sheraton and Aloft, as we are looking at secondary Russian markets (cities with 300K+ population) including Omsk, Chelyabinsk, Voronezh, Khabarovsk, Orenburg and Krasnoyarsk. Current accommodation supply in most of these destinations is below customer expectations and therefore stable demand is expected for a proper, internationally branded, hotel product.

Which of your brands are you focussing on for Russia and how do you see them fitting into the market?

We are trying to meet the market needs, but our aim is also to bring new initiatives, educate developers, share the most advanced technologies and products with customers so that they can enjoy staying in our hotels even more.

In Moscow and St. Petersburg all of our brands from top luxury St. Regis and Luxury Collection, stylish W, innovative Westin and Le Méridien to mid-scale Four Points by Sheraton and Aloft will find their niche. In major cities and capitals there is a great potential for our core and most recognized brand Sheraton. Practice shows that regional cities offer good opportunities to Four Points by Sheraton and Aloft and we are glad to cooperate with developers to help them build these hotels.

How do you see the market in terms of performance indicators in Moscow, and then in other more regional locations, at present and forecasts for the short to mid-term?

In terms of occupancy and average rate 2012 was in Russia a slightly better year than 2011 and that is a positive indicator for further development and growth. Demand in the region is still strong and we expect this trend to continue. As already mentioned earlier there are many locations with no international hotel supply and independent hotels that work there at present are operating very successfully. With the first international hotels coming to those markets the level of service and product will seriously improve. While occupancy may stay the same, this new offer of quality accommodation has a positive impact on increasing average rates. At the same time we notice that existence of an international hotel in a location in combination with global sales power brings additional travellers to such location.

Is the Russian market still heavily reliant on certain key sectors such as Oil and Gas driven business, or is it diversifying reasonably well (or at least showing potential to) into other segments now?

Russia's economy is still heavily dependent on oil and natural gas exports.

Can you explain some of the challenges that may exist in order to enter the Russian market and do business there?

Many businesses decide to expand to Russia, as the country has a massive business potential. For example, international retail chains see potential in every Russian city with a population over 500,000 inhabitants. However, entering the market can be challenging. One of the first and major challenges that a new business faces is the Russian language and culture. International companies usually lack the knowledge on how to do business and operate in Russia. Therefore professional help with local expertise in the navigation through the country with its rather complex administration systems should not be

ignored. For us at Starwood it is important to have a local knowledge, local expertise not only to understand the market, but to know what customers think. We have hotels in more than 100 countries. We have local employment in these areas. And we have been in Russia for over 20 years.

More specifically, how does this influence the hotel development stage, i.e. what must be considered?

Like in many other countries there are a number of permits to obtain to build a hotel and Russia is not an exclusion of this rule. In some cases that process just takes longer than 3 years and any developer should be prepared to that.

Are there any specific hotel operational differences in Russia you can highlight compared to more mature markets such as in Western Europe?

In general international operators manage to line up hotel operation in CIS with the standards that work in Europe or North America. There are little differences related to bureaucratic accounting and tax requirements as well as currency controls. The latter, for example, leads to the inability of guests to have currency exchanged at the hotel's reception and therefore each hotel has a small bank office / exchange booth designed in line with some rules somewhere near the front desk.

How does this affect your decision of where to open, or more precisely, what brand to open there?

The location is normally brought to us by a developer and if it is accepted for a hotel project at all only then we decide what brand would work best together with them. The selection of the brand depends on the specific location, neighbourhood and local competition, but as mentioned earlier in most of the cases Sheraton, Four Points by Sheraton or Aloft would work well – those brands are economically reasonable for both developers and customers. At some greater sites in major cities we may be able to offer Le Méridien, Westin, W, St. Regis or Luxury Collection provided that such an investment would be feasible for an investor and in the respective location.

Is the cost structure of operating a hotel in Russia is different from that in Europe? How so?

From a big picture the costs in Russia and CIS are structured in the same way as anywhere else in the world. Payroll and employee costs are traditionally low in emerging markets and that leads to higher levels of gross operating profit in the region despite that fact that employee ratios (employees to available rooms) are quite high (1:1 for a mid-scale hotel and 2.5:1 for upper upscale hotels). Cities like Moscow and St. Petersburg are becoming more expensive in terms of hiring and that hits the profitability making it similar to profitability in developed markets.

Finally, what are some of the key advantages and disadvantages of Russia as a hotel market?

I would hardly find major disadvantages of Russia and CIS as hotel market, especially today, when this region gives us a great opportunity for growth. There are some tasks that we need to accomplish to continue and build on the success of our business here in the region. Those tasks include education of developers and owners of what proper hotels are in terms of guest satisfaction and effective operation that leads to faster return on investment.

In every market where we've operated having a strong local presence is the best way for us to grow demand for outbound travel as well. In the short time we've had W opened in St. Petersburg we've seen a huge increase in demand for W and interest in W among Russian travelers who are going outside Russia today. In fact, that number has more than tripled in the first 12 months since we've opened that hotel. We think that's something that will continue with other brands that we are planning to bring to the region, i.e. Aloft, Four Points by Sheraton and Luxury Collection. And this is a great advantage of this emerging market.