



The February Lodging Margin Monitor: How profitable were hotels last month?

January saw -60 bps. of GOP margin growth on approx. +1% RevPAR

What's Incremental To Our View

In our new series we introduced in December, we analyze operational level P&L metrics for hundreds of U.S. upper-tier full service hotels (data source: HotStats). While monthly RevPAR results are well disseminated and understood thanks to STR, actual hotel operating profitability over the past month is far less known. We believe this report will help disperse some of the fog that investors have regarding hotel-level profitability in hotel REITS as well as C-corps with owned hotels, profitability trends intra-quarter, and how cost trends will impact margins in future periods.

We have analyzed monthly P&L metrics of hundreds of high-rated full-service hotels in the U.S. (luxury and upper upscale hotels, both private and publicly owned).

- The hotels in our January data set saw modest profitability loss with GOP margins -60 bps. y/y, driven by RevPAR growth of +0.7% and Total RevPAR (includes F&B) of +2.1%. **The downward trend-line in operating profitability remains a concern for 2018.** As Luxury hotel RevPAR outperformed Upper Upscale by +250 bps in January (per STR), we also project comparable divergence of GOP margins for the two chain scales. However, we believe the variance is partly attributable to the New Year's calendar shift.
- Subsequently we estimate based on 1Q18 RevPAR projections for full-service branded domestic hotels of +0-2% (the typical Hilton [HLT, \$82.14, Buy], Hyatt [H, \$78.56, Hold], or Marriott [MAR, \$141.35, Hold]) that 1Q18 GOP margins for domestic branded full-service hotels will be flattish. (Note that this range is an average for this segment of the industry and individual hotels and hotel REITS often have idiosyncratic issues which create more volatility vs. expectations.)
- We note that many Lodging REITS currently estimate Rooms RevPAR growth of +2-3% is needed to maintain flat EBITDA margins.

The data (source: HotStats (high correlation to STR)) indicates marked increases in hotel labor costs in the last year, negatively influencing hotel margins. **Bottom line, we remain guarded about the ability for owned hotel EBITDA margins (barring any major self-help initiatives such as with Park (PK, \$26.54, Buy)) to grow in 2018 as RevPAR of +0-2% in an environment of property-level operating costs of 3%+ does not bode well for margin expansion for hotel owners.**

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What's Inside

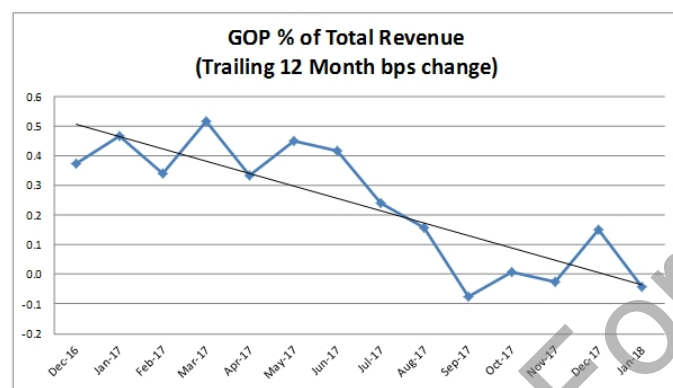
An analysis of recent hotel labor cost trends, one of the critical components impacting hotel EBITDA margins

- LaSalle (LHO, \$25.16, Hold) noted in their 4Q earnings call "that the sell-side community tends to focus predominately on the RevPAR...that's just one component...for [LHO] it's not only [about] RevPAR, but [also] profitability". Our analysis focuses on the profitability, a critical marker for REIT valuation and relative performance.

January profitability: Low RevPAR growth, particularly among Upper Upscale hotels, contributed to a moderate reduction in margin. As evident in the table below, Operating Department and GOP Profit margins declined 70 bps and 60 bps, respectively.

Industry Metric	Jan 2018 y/y		Jan 2018	FY2017	2017 y/y
Occupancy	0.4	bps	68.9%	77.2%	0.5 bps
ADR	0.1%	%	\$219	\$219	1.1%
RevPAR	0.7%	%	\$151	\$169	1.9%
Total Revenue PAR	2.1%	%	\$259	\$278	2.5%
Total Dept. Profit % Total Rev.	-0.7	bps	55.9%	59.6%	230 bps
Total Hotel Labor Costs % Total Rev.	0.3	bps	39.7%	35.5%	180 bps
Total GOP PAR	0.0%	%	\$83	\$103	3.0%
Total GOP % of Total Rev.	-0.6	bps	31.9%	37.0%	0.1 bps

Source: STRH Research, HotStats

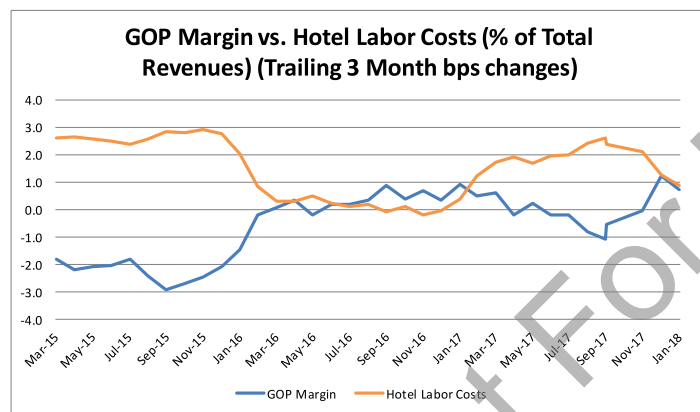
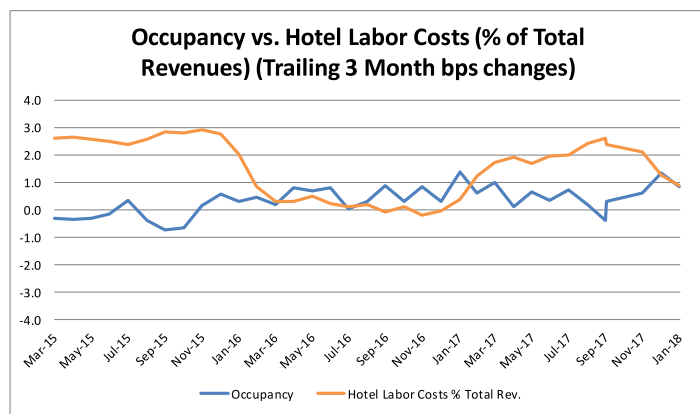


Source: STRH Research, HotStats

As we noted in our December report, hotel labor is the primary operating cost for most hotels and is particularly significant for full-service hotels (food and beverage, catering/meetings, and resort facilities are labor intensive). Our general view is that higher room rates generally equate to greater service expectations by guests. **Being that most of the Lodging REITS focus on the highest-rated hotels, the recent trend of rising labor costs is especially impactful to EBITDA margins.**

We analyzed HotStats' aggregated hotel P&L data to better grasp recent monthly trends in labor costs and margins. We note the following takeaways:

- **The rising operating costs attributable to labor appear to have increased significantly in the last year.** Labor costs as a percentage of total revenue were essentially unchanged y/y in 2016 whereas they increased by 150 bps. y/y in mid-2017 and to +180 bps by year-end. Combined with just 2% RevPAR growth in 2017, GOP margins were flattish in 2017 y/y. **We believe that restrictive immigration policies, low unemployment, and recent minimum wage ordinances are contributing to rising hotel labor costs -- and we do not expect these increases to plateau in the near-term.**
- The following charts highlight trends in labor costs vs. occupancy and GOP margins. While the trailing three-month labor costs have fallen, we attribute some of this to seasonality with the calendar shifts and not to a reversal of rising costs.



How we view property-level margins in the current low RevPAR growth environment: Over the past few years, in a low RevPAR growth environment, hotel labor costs have had a highly significant influence on EBITDA margins. The correlation between labor costs as a percentage of hotel revenue and GOP as a percentage of total revenue is -79%. **Thus, the ability for hotel owners and managers to keep labor cost increases as low as possible will be critical in 2018.**

- Among our REIT coverage, our aggregated Adjusted EBITDA Margin estimate (weighted average by market cap.) is flattish y/y growth for 2018 (ex-San Francisco hotels it would be closer to -50 to -100 bps). Please note that there are anomalies for specific REITS due to portfolio changes and property renovations, hurricane impact, DC Inauguration, etc. thus we focus on the aggregate numbers.

One piece of good news for hotel owners is that lower margins can result in a slowdown of new hotel development, at least for full-service hotels. However, we note that the highest-rated hotels often take the longest to go through the approval and development process, therefore we believe any warning signs on margins will likely play a factor for hoteliers that are very early in the development process and not necessarily for hotels that are well into the planning stages (thus, hotels that are scheduled to open in 2018 are still likely to open).

How this cycle compares with the prior downturn: One question we have raised to hotel owners as of late (both public and private owners) is "how efficient are hotels today vs. the same time last cycle?". This is an important question as many full-service hotels were able to cut costs significantly during the last cycle downturn. Hotel owners admit that there is room to cut costs if occupancies take a more significant downward trend (we are not suggesting this will happen barring a demand shock). However, owners have also admitted to us that some operating costs (labor and otherwise) that were cut during the last lodging cycle were not added back, thus we believe that many hotels may be naturally leaner and more efficient today. If hotels are leaner today, the ability to cut costs in a high occupancy environment may be more difficult.

Not For Investment Purposes

H: Valuation and Risks

Our price target of \$80 for H is derived by applying a 13.9x target EV/EBITDA multiple (a blended average of the industry multiples for each business segment) to our estimate for 2019 EBITDA. Our valuation model for Hyatt assumes an owned-hotel 2019 EBITDA multiple of 13.0x and a franchise/management fee EBITDA multiple of 15.0x.

Upside risk: transient and group trends outperform expectations.

Downside risk: ongoing misexecution and volatility.

HLT: Valuation and Risks

We apply a blended multiple of 15.6x (10.5x for Owned/leased and 16.0x for Managed/franchised) to our 2019 adjusted EBITDA estimate to derive a 12-month price target of \$92. This multiple is towards the higher end of the historical range of 10x-16x.

Risks include:

Press reports (FT, Bloomberg, etc.) **have indicated possible financial difficulties at HNA, a 25% holder of HLT shares.** If HNA should have to liquidate HLT we believe this would create near-term pressure on the shares. Separately, HNA interests (as a travel industry conglomerate) could conflict with other shareholders.

Growth trajectory could disappoint. Pipeline growth could either slow down or projects scheduled for construction could be cancelled, which would diminish system growth for the firm and disappoint investors.

MAR: Valuation and Risks

Our price target of \$128 for MAR is derived by applying a 15.8x target EV/EBITDA multiple (a blended average of the industry average multiples for each business segment) to our estimate for 2019 EBITDA.

Upside Risk: Significant U.S macroeconomic improvement results in large recovery in transient corporate demand (and consequential >400 bps RevPAR improvement). Owned assets sell for premium prices relative to MAR expectations.

Downside Risk: 2018 is a recession year in the US. Geopolitical and policy risks negatively impact lodging demand.

PK: Valuation and Risks

Our \$32 price target is based on an 12.5x multiple on our 2019 EBITDA estimate. This multiple is in-line with portfolio quality.

Downside risk: Significant supply growth and macroeconomic challenges/shocks. Press reports (FT, Bloomberg, others) have indicated possible financial difficulties at HNA, a 25% holder of PK shares. If HNA should have to liquidate PK we believe this would create near-term pressure on the shares.

Companies Mentioned in This Note

Hyatt Hotels Corporation (H, \$78.56, Hold, C. Patrick Scholes)

Hilton Worldwide Holdings Inc. (HLT, \$82.14, Buy, C. Patrick Scholes)

LaSalle Hotel Properties (LHO, \$25.16, Hold, C. Patrick Scholes)

Marriott International, Inc. (MAR, \$141.35, Hold, C. Patrick Scholes)

Park Hotels & Resorts Inc. (PK, \$26.54, Buy, C. Patrick Scholes)

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I, C. Patrick Scholes, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

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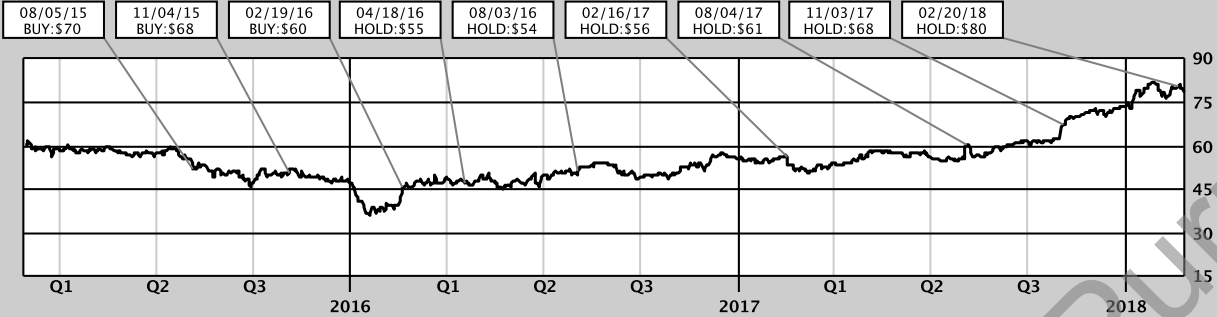
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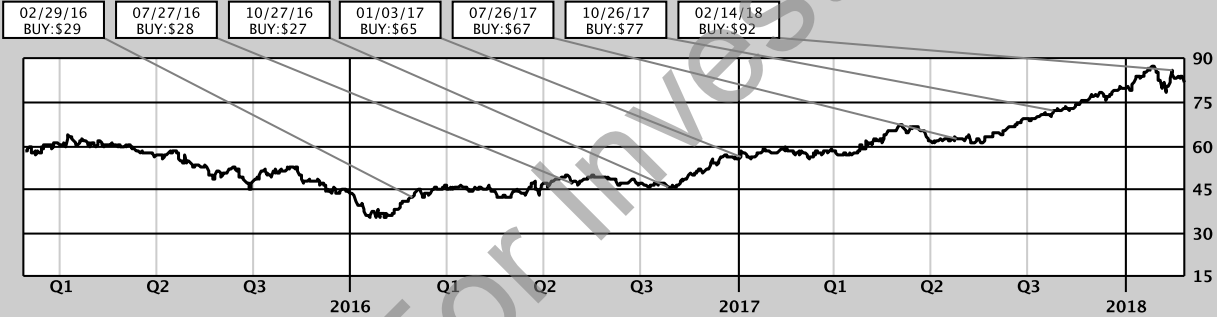
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Rating and Price Target History for: Hyatt Hotels Corporation (H-US) as of 02-26-2018

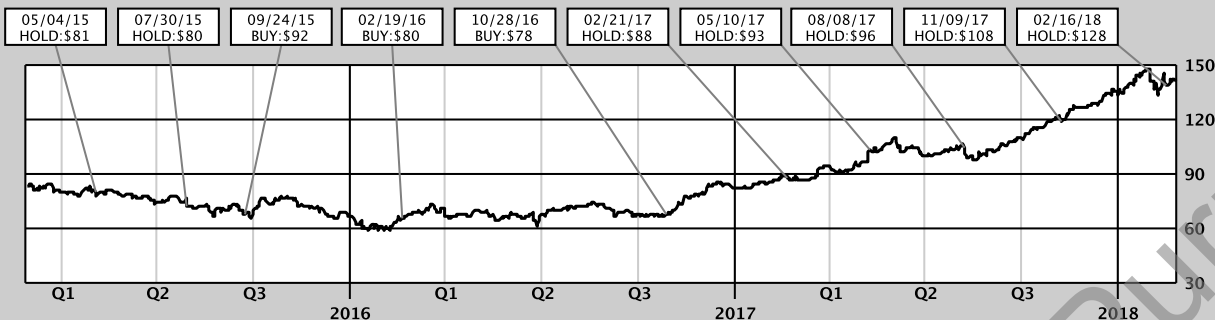


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Rating and Price Target History for: Hilton Worldwide Holdings Inc. (HLT-US) as of 02-26-2018



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Rating and Price Target History for: Marriott International, Inc. (MAR-US) as of 02-26-2018


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Rating and Price Target History for: Park Hotels & Resorts Inc. (PK-US) as of 02-26-2018


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Legend for Rating and Price Target History Charts:

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- NR – NOT RATED, STRH does not provide equity research coverage
- CS – Coverage Suspended

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Hold/Neutral	266	37.46%	Hold/Neutral	68	25.56%
Sell/Reduce	1	0.14%	Sell/Reduce	0	0.00%

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